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European Aviation Regulation: Flying Through the Liberalization Labyrinth†

Paul Stephen Dempsey*

INTRODUCTION

European aviation policy is the product of conflicting and competing legal, economic, and political interests.¹ The principal actors include scores of airlines—most publicly owned or subsidized,² the twelve nation European Community (EC or Community),³ and a number of air transport associations including the Association of European Airlines (AEA), the International Air Transport Association (IATA), and the European Civil Aviation Conference (ECAC).⁴ The issue is further complicated by a labyrinth of bilateral agreements,⁵ EC treaties, regulations and directives, and a growing regional air transport market.⁶

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¹ See generally *Europe's Air Cartel*, ECONOMIST, Nov. 1, 1986, at 23 [hereinafter *Air Cartel*]; PAUL S. DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION 93–107, 241–55 (1987).

² *Air Cartel*, *supra* note 1, at 23. Many European nations, however, are exploring privatization of their national airlines. For example, British Airways was recently privatized. Recently, the French government provided Air France with \$400 million, the Belgian government gave Sabena \$300 million, and the Italian government gave Alitalia \$300 million. DOT Says "Hands Off" Best Approach to Helping Competition, AV. DAILY, (Mar. 6, 1991), at 427.

³ The twelve Member States are Belgium, the Netherlands, Luxembourg, France, Germany, Italy, Denmark, Greece, Ireland, Portugal, Spain, and the United Kingdom.

⁴ EEC Deregulation Proposal Blocked While ECAC Plan Proceeds, AV. WK. & SPACE TECH., July 7, 1986, at 33.

⁵ See generally Dr. J. Naveau, *Bilateralism Revisited in Europe*, 10 AIR L. 85 (1985); DEMPSEY, *supra* note 1, at 47–75.

⁶ Michael Feazel, EEC Officials Draft New Directive to Ease Regional Airline Regulation, AV. WK. & SPACE TECH., Apr. 14, 1986, at 37.

European nations, particularly those belonging to the EC, are entering a new era in air transport. Traditionally, European governments heavily regulated their airlines.⁷ Several European governments either own or subsidize their carriers.⁸ Additionally, national governments have shielded their airlines from the rigors of the marketplace, perceiving the industry to have public utility characteristics. Governments utilized air carriers to promote public policy objectives beyond allocative efficiency, such as increasing tourism and foreign exchange, augmenting international prestige, enhancing national security, reducing domestic unemployment, and promoting domestic aircraft manufacturing.⁹

Many EC Member States, however, are now reexamining their positions and moving toward liberalization. In the 1980s, Britain and the Netherlands led the fight for air transport liberalization, concluding a number of liberal bilateral transport agreements with other nations.¹⁰ Meanwhile, the more conservative southern European nations, such as France and Greece, advocated a more

⁷ Michael Feazel, *New GATT Negotiations Could Give Impetus to Airline Deregulation*, AV. WK. & SPACE TECH., Sept. 8, 1986, at 58. For an overview of early international negotiations for air rights, see Jeswald W. Salacuse, *The Little Prince and the Businessman: Conflicts and Tensions in Public International Air Law*, 45 J. AIR L. & COM. 807, 809-32 (1980); DEMPSEY, *supra* note 1, at 7-22. United States aviation was also heavily regulated prior to 1978. See PAUL S. DEMPSEY & WILLIAM E. THOMS, LAW AND ECONOMIC REGULATION IN TRANSPORTATION 26-29, 121-33 (1986).

⁸ The percentage of capital held by Member States in the main EC scheduled airlines was as follows in 1979:

Air France	98.80
Air Inter	49.90
Alitalia	99.00
British Airways	100.00
KLM	78.00
Aer Lingus	100.00
Lufthansa	82.16
Luxair	25.57
Sabena	100.00

BULL. EUR. COMM. SUPP. 35 (May 1979) (cited in Leah E. Clifton, Comment, *Introducing Competition to the European Economic Community Airline Industry*, 15 CAL. W. INT'L L.J. 364, 365 n.7 (1985)). More recently, a number of European airlines have been partially or wholly privatized. For example, British Airways has been completely privatized and the Dutch government today holds only a 39 percent interest in KLM. See DEMPSEY, *supra* note 1, at 83.

⁹ Frederik Sorensen, *Progress Towards the Development of a Community Air Transport Policy*, IATA MAG., June-July 1985, at 3, 7-8; Paul S. Dempsey, *Turbulence in the "Open Skies": The Deregulation of International Air Transport*, 15 TRANSP. L.J. 305, 362-63 (1987) [hereinafter *Turbulence*].

¹⁰ Michael Feazel, *European Civil Aviation Leaders Commit to Increased Liberalization*, AV. WK. & SPACE TECH., June 24, 1985, at 36 [hereinafter *Increased Liberalization*].

modest relaxation of the regulatory reins.¹¹ New airlines, such as Ireland's Ryanair, entered the market to take advantage of areas amenable to competition.¹² Some established airlines, including KLM and British Airways, advocated increased liberalization.¹³

Moreover, the EC has promulgated regulations mandating intra-Community air transport liberalization. The Treaty of Rome (EEC Treaty) established the EC in 1957 for the purpose of enhancing economic efficiency among the western European nations.¹⁴ The EEC Treaty includes rules intended to promote competition in various economic sectors, including transportation.¹⁵ The four governing bodies of the EC—the Council, the Commission, Parliament, and the European Court of Justice (ECJ or Court)—share responsibility to interpret and implement these rules.¹⁶ Each has its own conception of how the EEC Treaty's competition rules should be applied to air transport.

The U.S. experience with deregulation has also affected the EC's action in the air transport area. After the United States deregulated its domestic air transport market, it began to export its deregulatory ideology. In turn, many foreign observers began to argue that rigid regulation and price-fixing created inefficient markets and excessively high fares.¹⁷ Those proposing liberalization abroad¹⁸ have targeted capacity controls,¹⁹ tariff coordi-

¹¹ *Id.* See also *British Caledonian Reduces AEA Activity in Deregulation Dispute*, AV. WK. & SPACE TECH., Oct. 7, 1985, at 36 (discussing attitudes of European airlines toward deregulation) [hereinafter *British Caledonian*].

¹² Sean D. Barrett, *Irish Airline's Model for Deregulation*, WALL ST. J., Dec. 10, 1986, at 35.

¹³ *British Caledonian*, *supra* note 11, at 36.

¹⁴ TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [EEC TREATY]. Salient provisions are set forth in DEMPSEY, *supra* note 1, at 451–59.

¹⁵ EEC TREATY art. 3.

¹⁶ LOUIS HENKEN ET AL., INTERNATIONAL LAW 1077 (1980).

¹⁷ See, e.g., RYAN C. AMACHER, PRINCIPLES OF MACROECONOMICS 318–19 (2d ed. 1983). For an examination of U.S. domestic airline deregulation and its exportation abroad, see generally Paul S. Dempsey, *The Rise and Fall of the Civil Aeronautics Board—Opening Wide the Floodgates of Entry*, 11 TRANSP. L.J. 91 (1979), and Paul S. Dempsey, *The International Rate and Route Revolution in North Atlantic Passenger Transportation*, 17 COLUM. J. TRANSNAT'L L. 393 (1978).

¹⁸ Barrett, *supra* note 12, at 35 (not discussing pooling agreements).

¹⁹ Capacity is defined as the total number of available aircraft seats on given air routes over a given time period, usually expressed in terms of available-seats/kilometers. Capacity controls are concluded in bilateral air transport agreements between nations. *Analysis by the Council of Europe, Committee on Economic Affairs and Development of U.S. Deregulation of Air Transport and Its Inferences for a More Liberal Air Transport Policy in Europe*, May 21, 1984, at 79; Civil Aviation Memorandum No. 2, Progress Towards the Development of

nation and price-fixing,²⁰ market access restrictions,²¹ and revenue sharing, or "pooling" agreements.²²

This Article traces the movement in the EC toward air transport liberalization. Part I outlines the various air transport organizations in the EC and discusses their positions on liberalization. Part II examines actions which Member States have taken, and discusses how these actions foreshadow multilateral agreements. Part III discusses the EEC Treaty's competition rules and their applicability to the field of air transport. Part IV details how the EC institutions have utilized the EEC Treaty to develop a unified European transport policy. Part V reveals how the Single European Act has enhanced the ability of EC governing bodies to institute a more liberal air transport policy. Part VI examines contemporary EC air transport policy and proposals for the future. Part VII briefly considers the relevance of EC merger regulations to air transport. Part VIII discusses EC regulation of non-economic air transport issues. Finally, Part IX of this Article looks into the future of EC air transport and examines the prospects for further liberalization. This Article concludes that significant liberalization of EC air transport will likely continue.

I. AIR TRANSPORT ORGANIZATIONS

Air transport organizations wield tremendous influence in the European air transport industry.²³ The interests and objectives of each organization differ. Nevertheless, growing support exists among them for liberalization of European air transport.

Community Air Transport Policy, COM(84)72 final at 32-33 [hereinafter MEMORANDUM 2].

²⁰ Governments impose price controls to guarantee revenues and enhance the viability and stability of airlines.

²¹ Market access restrictions are agreements determining which airlines will be granted particular air rights. See Dr. Z. Joseph Gertler, *Nationality of Airlines: A Hidden Force in the International Air Regulation Equation*, 48 J. AIR L. & COM. 51, 54 (1982).

²² Pooling agreements between airlines equalize the revenue between airlines based on capacity offered. MEMORANDUM 2, *supra* note 19, at 33. Traditionally, 70 to 80 percent of the route-miles performed in Europe have been subject to pooling agreements. Michael Feazel, *ECAC Leaders Expected to Approve Liberalized Regulatory Proposals*, AV. WK. & SPACE TECH., June 17, 1985, at 28, 29.

²³ See Paul S. Dempsey, *The Role of the International Civil Aviation Organization on Deregulation, Discrimination, and Dispute Resolution*, 52 J. AIR L. & COM. 529, 532-40 (1987).

A. *International Air Transport Association*

IATA is composed of more than 100 air carriers, including airlines from all EC Member States except Luxembourg.²⁴ More than 70 percent of IATA member routes serve Europe.²⁵ As one of the most influential airline organizations in the world,²⁶ IATA organizes conferences for the coordination of tariffs.²⁷ Following these conferences, airlines file the proposed tariffs with their respective governments.²⁸

IATA concedes that liberalization is inevitable.²⁹ It does not, however, support total deregulation.³⁰ Deregulation of U.S. airlines eliminated IATA's tariff-setting role in the world's largest airline market—the United States.³¹ On May 6, 1981, the U.S. Civil Aeronautics Board (CAB) issued a show cause order proposing to eliminate antitrust immunity for U.S. carriers from participating in IATA Tariff Coordinating Conferences.³² The CAB found that the rate-fixing portion of the conference agreements substantially reduced competition.³³ The CAB, however, was sunset on December 31, 1984, before it issued a final decision in the IATA proceeding.³⁴ The U.S. Department of Transportation, which inherited the CAB's jurisdiction over international aviation, terminated this controversial proceeding in 1985.³⁵ Nevertheless, deregulation of the U.S. air transport industry created a new problem for IATA—the potential loss of U.S. antitrust immunity.³⁶ IATA responded by dividing itself into a Trade Association and a Traffic Conference. The Traffic Conference, in

²⁴ DEMPSEY, *supra* note 1, at 269.

²⁵ Marianne Barnabo, *Regulatory Reform in Europe*, IATA REV., Oct.–Dec. 1985, at 11.

²⁶ DEMPSEY, *supra* note 1, at 269.

²⁷ *Id.* at 38–45.

²⁸ *Turbulence*, *supra* note 9, at 313–15.

²⁹ Donald E. Fink, *Transport's Long Haul to Profits*, AV. WK. & SPACE TECH., Nov. 11, 1985, at 11.

³⁰ *Deregulation Drive Stalls Out at IATA Annual General Meeting*, TRAFFIC WORLD, Nov. 12, 1984, at 44 [hereinafter *Deregulation Stall*].

³¹ *Liberal Regulatory Environment Alters IATA's Fare-Setting Role*, AV. WK. & SPACE TECH., Nov. 11, 1985, at 103 [hereinafter *Liberal Regulatory Environment*].

³² George N. Tompkins, Jr., *The North Atlantic—Competition or Confrontation*, 7 AIR L. 48, 49 (1982); DEMPSEY, *supra* note 1, at 40–45.

³³ Order No. 81–5–27, 89 C.A.B. 468, 498 (1981).

³⁴ *Turbulence*, *supra* note 9, at 353–54.

³⁵ *Id.*

³⁶ *Deregulation Stall*, *supra* note 30, at 45.

which membership is discretionary, is devoted to ratemaking activities.³⁷

IATA's recognition that a relaxation of regulatory controls is inevitable has recently led it to support modest liberalization.³⁸ For example, in the early 1980s, IATA suspended compulsory participation in tariff negotiations by IATA members, and discontinued imposition of conditions of in-flight service in agreements.³⁹ IATA also began formal meetings with non-members.⁴⁰ Furthermore, structural changes within the IATA Tariff Conferences are making it easier to experiment with new fares and services.⁴¹ One important change shifted the burden of proof from the carriers proposing new fares to airlines opposing them.⁴² Moreover, only the airlines involved in the route may participate in discussions of fares on that route, whereas previously any carrier could object to a proposed fare.⁴³

Some commentators have accused IATA of violating the EEC Treaty's competition laws through its tariff coordination activities.⁴⁴ IATA price-fixing potentially violates Article 85, which prohibits the direct or indirect "fixing of purchase or selling prices or of any other trading conditions."⁴⁵ Consumers, however, receive no direct benefit from price-fixing. Article 85(3) of the EEC Treaty contains provisions creating an exception to the competition laws for agreements which "contribute to the improvement of the production or distribution of goods . . . while reserving to users an equitable share in the profits resulting therefrom" ⁴⁶ Thus, Article 85(3) does not apply.⁴⁷

³⁷ DEMPSEY, *supra* note 1, at 42.

³⁸ *Liberal Regulatory Environment*, *supra* note 31, at 105.

³⁹ Milford L. Coor, *International Air Fares in Europe*, IATA MAG., Jan.-Mar. 1985, at 11.

⁴⁰ *Liberal Regulatory Environment*, *supra* note 31, at 102.

⁴¹ *New Agreements Spur European Liberalization*, AV. WK. & SPACE TECH., Nov. 12, 1984, at 71 [hereinafter *New Agreements*].

⁴² *Id.* at 76.

⁴³ *Id.*

⁴⁴ Letter from Knut Hammar skjold, IATA Director General, to G. Contogeorgis, Commissioner, European Economic Communities, Attachment A at 6 (Dec. 28, 1981) (on file with author) [hereinafter Letter from Knut Hammar skjold]; DEMPSEY, *supra* note 1, at 269.

⁴⁵ EEC TREATY art. 85(1).

⁴⁶ *Id.* at art. 85(3).

⁴⁷ P.D. Dagtoglou, *Air Transport and the European Community*, 6 EUR. L. REV. 335, 352 (1981).

While IATA still serves important functions in tariff-setting, its absolute power has been diminished. In a practical sense, IATA has been transformed from an international quasi-regulatory agency to an influential trade association.⁴⁸

B. *European Civil Aviation Conference*

ECAC, representing twenty-two European states, proposes recommendations and resolutions which its members consider and often implement as regulations.⁴⁹ Although it does not possess direct regulatory power, ECAC nonetheless strongly influences European air transport policies.⁵⁰ ECAC was responsible for Europe's first step toward deregulation, with its 1965 multilateral agreement on non-scheduled, or charter, services. Today, chartered carriers account for more than 50 percent of Europe's passenger air transport.

In 1987, the leading aviation officials of ECAC unanimously issued a policy statement committing their governments to increasingly liberal regulatory schemes.⁵¹ Senior aviation officials of all twenty-two member countries have endorsed ECAC's commitment to liberalization.⁵² Additionally, the policy statement lays a foundation for further agreements. It includes proposals for more flexibility in fare-setting, increased opportunity to enter new markets, and reduced emphasis on pooling agreements. Nearly every nation involved with drafting the policy statement, however, was dissatisfied with some portion of it. The principal disagreement concerned the extent to which airlines would be protected in the areas of pricing and entry by governments.⁵³

Despite the internal disagreement, ECAC has engaged in policy negotiations with the United States. In October 1984, the United States and ECAC signed a Memorandum of Understanding liberalizing regulation of North Atlantic fares.⁵⁴ The pact set "zones

⁴⁸ *Liberal Regulatory Environment*, *supra* note 31, at 102.

⁴⁹ DEMPSEY, *supra* note 1, at 99–100. ECAC was formed in Strasbourg in 1954 to coordinate intra-European air services. Today, it is headquartered in Paris. It comprises the heads of the air transport ministries and civil aviation administrations of 22 west European nations. DEMPSEY, *supra* note 1, at 44 n.108.

⁵⁰ *Liberal Regulatory Environment*, *supra* note 31, at 105.

⁵¹ *Increased Liberalization*, *supra* note 10, at 36.

⁵² *Liberal Regulatory Environment*, *supra* note 31, at 105.

⁵³ *Increased Liberalization*, *supra* note 10, at 36.

⁵⁴ This pact was signed by the United States, Italy, Belgium, France, West Germany, Greece, the United Kingdom, Norway, Denmark, Finland, Ireland, Yugoslavia, Switzer-

of reasonableness" for North Atlantic fares through April 30, 1987.⁵⁵ A two-year memorandum with even more liberal provisions was signed in February 1987. The agreement established deep-discount fare zones of an average of 10 percent, and allowed such fares to be offered with fewer restrictions.⁵⁶ Under this arrangement, airlines have freedom to set transatlantic fares without government intervention as long as they fall within an agreed-upon percentage above or below a reference price.⁵⁷

Liberalization in the areas of rates and capacity took an important step forward in December 1986 for the twenty-two ECAC member nations, which include all EC Member States,⁵⁸ when the ECAC concluded two additional Memoranda of Understanding regarding intra-European scheduled air tariffs and capacity sharing. The tariff memorandum was the first major effort to embrace a tariff scheme where governments automatically approve rates falling within a specific range. It established a Discount Zone of 90 to 65 percent of the reference price and a Deep-Discount Zone of 65 to 45 percent of the reference price.⁵⁹ The memorandum on capacity sharing allows either participating nation to provide up to 55 percent of the market's capacity, an increase from the previous 50/50 sharing standard.

C. *Association of European Airlines*

AEA promotes the interests of the airlines in the EC and at air transport conferences and represents the thirteen largest scheduled airlines in Europe. AEA is more conservative on the liberalization issue than IATA or ECAC. It has approved a policy

land, the Netherlands, Portugal, Spain, and Sweden. *U.S., ECAC Sign Atlantic Fare Pact*, AV. WK. & SPACE TECH., Oct. 22, 1984, at 33 [hereinafter *Atlantic Fare Pact*]; see *Turbulence*, *supra* note 9, at 353.

⁵⁵ *U.S. European Carriers Extend Agreement on North Atlantic Fares*, AV. WK. & SPACE TECH., Apr. 8, 1985, at 31.

⁵⁶ *ECAC, U.S. Renew North Atlantic Pact*, AV. WK. & SPACE TECH., Feb. 23, 1987, at 32. The agreement is effective for a two-year period, beginning April 1, 1987. The following 16 ECAC Member States are affected by it: Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, and Yugoslavia.

⁵⁷ *Atlantic Fare Pact*, *supra* note 54, at 33.

⁵⁸ *ECAC Approves Liberalizing Fare, Capacity Regulations*, AV. WK. & SPACE TECH., Jan. 12, 1987, at 36.

⁵⁹ Passengers had to satisfy certain conditions in order to qualify for the discount prices.

calling for only limited liberalization,⁶⁰ including proposals for flexibility in capacity, tariffs, market access, and state aid.⁶¹

AEA's position on the political and regulatory issues is influenced by its objective of providing an economically sound and stable air transport industry. In its proposals, AEA has consistently considered the special relationship between airlines and their governments, and the potential dangers of putting European airlines at a competitive disadvantage. AEA prefers a pragmatic approach for gradual change which would ensure orderly competition, maintain benefits or "inter-airline" coordination, and avoid additional regulatory controls.⁶²

AEA supports flexibility in capacity, tariffs, market access, state aid, and competition rules, subject to exemptions and certain limitations on geographical scope.⁶³ Its proposals lay down detailed rules for applying the competition rules of the EEC Treaty to air transport. These proposals suggest that the rules should apply only to international air transport between Community airports. They should neither apply to technical standards of improvement nor interfere with relations and agreements with non-member states.⁶⁴ AEA also advocates capacity agreements which would provide the following three measures: (1) airline facilities used by the traveling public be proportional to the public's requirements; (2) fair and equal opportunity be granted to airlines of any two states to use any route between them; and (3) each state consider the other state's requirements and services.⁶⁵

AEA is a major supporter of the Tariff Reform Action Package of 1985. This package included streamlined conference procedures, revamped Traffic Conference Bulletins with a special European edition circulated to all European governments and regulatory institutions, and improved consumer contacts.⁶⁶ AEA also

⁶⁰ *European Airline Balance Shifts Toward Deregulation*, AV. WK. & SPACE TECH., NOV. 4, 1985, at 31 [hereinafter *European Airline Balance*]. AEA members were divided on the issue of liberalization. Aer Lingus, British Airways, British Caledonian, Iberian, KLM, and UTA would have preferred a more liberal position. Air France led the opposition, advocating a more heavily regulated environment. *Id.* at 29.

⁶¹ *Cf.* Barrett, *supra* note 12, at 35 (criticizing restraints on these areas).

⁶² President's Special Assembly of the Ass'n of European Airlines, *European Air Transport Policy—AEA Proposals*, Sept. 27, 1985, at 1 [hereinafter *European Air Transport Policy*].

⁶³ *Id.* at 1-21; *cf.* Barrett, *supra* note 12, at 35 (criticizing restraints on competition in capacity, market access, and fares).

⁶⁴ *European Air Transport Policy*, *supra* note 62, at 17-18, 145.

⁶⁵ *Id.* at 7.

⁶⁶ *See generally* Barnabo, *supra* note 25.

supported a tariff reduction package that would establish new zones for discount fares.⁶⁷

II. ACTIONS TAKEN BY INDIVIDUAL STATES: LIBERAL BILATERALS

The key to liberalization of the European airline industry ultimately rests with the individual EC Member States. As a practical matter, until recently the Council has been powerless to enact rules to apply the EEC Treaty to air transport without the unanimous consent of the Member States. Nor could recommendations of individual groups promoting liberalization be implemented without state action. Thus, state sovereignty has been a formidable obstacle to free competition in international aviation.⁶⁸

In the face of Council stagnation, several nations have turned to bilateral agreements as a vehicle for liberalization. These agreements serve to protect a nation's interests, its airlines, and its consumers from the effects of unrestrained competition.⁶⁹ Some of Europe's more liberal governments, in an attempt to encourage competition in certain markets, concluded new bilateral agreements during the 1980s or revised existing ones. These agreements offered a preview of what fares and services would resemble throughout Europe once a multilateral agreement was reached.⁷⁰

Traditionally, governments have employed bilateral agreements to avoid the impact of excessive competition harmful to their airlines.⁷¹ The bilaterals which have evolved provide for an exchange of air rights.⁷² These agreements often restrict capacity and market access, and provide for revenue pooling agreements.⁷³ Under revenue pooling agreements, traffic and revenues

⁶⁷ *European Airline Balance*, *supra* note 60, at 29.

⁶⁸ Colin Thaine, *The Way Ahead from Memo 2: The Need for More Competition and a Better Deal for Europe*, 10 AIR L. 90, 102-03 (1985).

⁶⁹ *Id.*

⁷⁰ Two years after Great Britain and the Netherlands deregulated air transport between the two countries, the Amsterdam-London route became the busiest in Europe with 210 weekly flights by seven scheduled airlines. *Airline Observer*, AV. WK. & SPACE TECH., NOV. 17, 1986, at 33; *see also More and Merrier*, *ECONOMIST*, NOV. 8, 1986, at 90; DEMPSEY, *supra* note 1, at 102-04.

⁷¹ Sorensen, *supra* note 9, at 4.

⁷² Clifton, *supra* note 8, at 376.

⁷³ *Id.* at 377.

are shared regardless of which carrier generates the traffic or earns the revenue.⁷⁴

During the 1980s, northern European states led the gradual shift away from bilateral agreements designed to protect air carriers from the ravages of too free a market. Deregulation of U.S. airlines increased competitive pressure on North Atlantic routes and spurred competition with European airlines.⁷⁵ Anxious to respond, the United Kingdom and the Netherlands led the fight for liberalization, insisting that both consumers and airlines would benefit from the pressures of the market place.⁷⁶ During the 1980s, the British government pushed aggressively for lower fares in Europe and was the common denominator in most new liberal fare agreements.⁷⁷

The U.K. agreement with Luxembourg, entered into in March 1985 was the first to liberalize route access, capacity controls, and tariff approvals.⁷⁸ This agreement provided for unrestricted market entry and capacity. Under the agreement, fares may be rejected only with consent of both governments. This provision is referred to as a "double disapproval" pricing provision.⁷⁹ The country of origin, however, may unilaterally reject a fare which it considers predatory or excessive in relation to costs.⁸⁰ The language of this agreement was used as a model for subsequent bilateral agreements.⁸¹ Furthermore, it became the type of agreement promoted by British Prime Minister Thatcher throughout the EC in the late 1980s.⁸²

In June 1984, Britain joined forces with the Netherlands in a major agreement which was far more liberal than existing bilaterals or EC proposals.⁸³ The 1984 agreement was followed by another in June 1985 which went further still. The 1985 agreement included several of the provisions of the Luxembourg agreement, while maintaining the 1984 provisions requiring the

⁷⁴ Thaine, *supra* note 68, at 94.

⁷⁵ *Liberal Regulatory Environment*, *supra* note 31, at 36.

⁷⁶ *Increased Liberalization*, *supra* note 10, at 36.

⁷⁷ *New Agreements*, *supra* note 41, at 75.

⁷⁸ STEPHEN WHEATCROFT & GEOFFREY LIPMAN, *AIR TRANSPORT IN A COMPETITIVE EUROPEAN MARKET* 65 (1986).

⁷⁹ David A. Brown, *Britain Urges Deregulation Effort in 1986*, *AV. WK. & SPACE TECH.*, Dec. 2, 1985, at 36.

⁸⁰ WHEATCROFT & LIPMAN, *supra* note 78, at 213.

⁸¹ *Id.* at 66.

⁸² Brown, *supra* note 79, at 36.

⁸³ *New Agreements*, *supra* note 41, at 76.

matching of fares on Fifth Freedom routes.⁸⁴ The 1985 agreement also gave carriers between the two countries almost unlimited opportunity to offer additional capacity and discount fares.⁸⁵ Under this agreement, any certified airline may fly to any point in either country and thereafter to a second point within the country or on to a third country. Schedules and capacity are not controlled, while fares are controlled by the country of origin.⁸⁶ The Dutch-British bilateral agreement prompted other, less sweeping agreements between Britain and West Germany, Switzerland, France, Finland, Greece, Spain, Italy, and Portugal.⁸⁷

In September 1985, the United Kingdom and France concluded an agreement. It was the most restrictive agreement entered into with Britain. It relaxed capacity sharing requirements from a rigid 50/50 split to an arrangement allowing one nation to carry up to 55 percent of the traffic.⁸⁸ This agreement also changed destination restrictions.⁸⁹ Given France's strong opposition to any kind of liberalization,⁹⁰ the conclusion of this agreement was a significant achievement.

In October 1985, the British bilateral with France was followed by an agreement with Belgium. This bilateral incorporated the most liberal provisions of the Luxembourg and Netherlands agreements.⁹¹ It provided unrestricted access and capacity. As in the Luxembourg bilateral, tariffs may be rejected only by the agreement of both governments. The bilateral also contains provisions for rejecting fares which are predatory or excessive in relation to costs.⁹²

In December 1985, Britain and Switzerland signed two new service agreements liberalizing airline regulation between Switzerland and Britain or Hong Kong.⁹³ The Swiss agreement liberalized route access and capacity control, but resembled an ear-

⁸⁴ A Fifth Freedom route is a route between two nations, neither of which is the home of the carrier serving the route. WHEATCROFT & LIPMAN, *supra* note 78, at 36-37.

⁸⁵ *New Agreements*, *supra* note 41, at 71.

⁸⁶ Brown, *supra* note 79, at 36.

⁸⁷ *New Agreements*, *supra* note 41, at 72-73.

⁸⁸ WHEATCROFT & LIPMAN, *supra* note 78, at 66.

⁸⁹ *Britain and France Agree to Liberalized Air Services*, AV. WK. & SPACE TECH., Oct. 14, 1985, at 41.

⁹⁰ DEMPSEY, *supra* note 1, at 103.

⁹¹ WHEATCROFT & LIPMAN, *supra* note 78, at 66.

⁹² Brown, *supra* note 79, at 36.

⁹³ *British, Swiss Sign New Air Services Pacts*, AV. WK. & SPACE TECH., Dec. 16, 1985, at 42.

lier British-German agreement in its tariff-setting provisions.⁹⁴ The sole change in tariff provisions was to require only country of origin approval with respect to special fares.⁹⁵

The efforts of the United Kingdom to create a European common market in aviation, as reflected in agreements with the Benelux countries, revolved around route access, capacity control, and tariff approval.⁹⁶ As set forth in the agreement with Luxembourg, for example, route access provisions ideally would allow airlines free entry to all airports. Airline access would be subject only to limitations on services available at airports. Provisions on capacity would allow airlines the freedom to decide unilaterally the appropriate capacity level, as long as their objective was to provide adequate capacity at reasonable load factors. Either country could call for consultations if it feels that its interests are being compromised.⁹⁷ With respect to tariff approval, new liberal bilateral agreements ideally would not require the airlines to consult together beforehand. Tariffs would be subject to the principle of double disapproval.⁹⁸ Thus, they would automatically become effective unless disapproved within thirty days by both governments.

Airline officials have argued that the bilateral agreements usurp EC regulation. Ulrich Meir, Lufthansa's Deputy General Manager for International Relations, argued that the Dutch-British agreement and subsequent bilateral agreements took the deregulation initiative away from the EC.⁹⁹ Rodney Muddle, British Airways General Manager for Pricing, suggested, "[t]he EC is a benchmark. It forces people to think about these issues and keep them in the public attention. But I think the main changes are going to be on a bilateral basis."¹⁰⁰ Other airline officials have suggested that progress being made on the bilateral front indicated a minimal need for EC-mandated action.¹⁰¹

⁹⁴ The British-German bilateral agreement was somewhat similar to the Dutch-British bilateral agreement. WHEATCROFT & LIPMAN, *supra* note 78, at 66. The British-German bilateral agreement liberalized route access, but only minimally improved tariff approval procedures. Brown, *supra* note 79, at 36.

⁹⁵ WHEATCROFT & LIPMAN, *supra* note 78, at 66.

⁹⁶ *Id.* at 66, 67.

⁹⁷ *Id.* at 66.

⁹⁸ See Brown, *supra* note 79 and accompanying text.

⁹⁹ *New Agreements*, *supra* note 41, at 75.

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 76.

On the other hand, authors Stephen Wheatcroft and Geoffrey Lipman argue that bilateral agreements maintain their momentum only as long as willing partners are available, thus the "U.K. liberal bilateral experiment is running out of steam"¹⁰² They base their conclusion on limited U.S. success in negotiating bilateral agreements both in the early and late 1980s. They also base it on the differing "competitive capabilities and national interests" of European states which leads to agreement only on provisions they perceive to be in their own best interests.¹⁰³ Moreover, considering that aviation constitutes only one of many factors making up the European economy, individual nations can use various economic and political influences to scuttle disfavored aviation bilaterals.¹⁰⁴

Despite the British initiatives, many scheduled carriers have declined to offer competitive rates.¹⁰⁵ Furthermore, with the privatization of British Airways, Britain retreated somewhat to a more conservative position than that evidenced by the liberal bilateral agreements.¹⁰⁶ By the early 1990s, the prospect for additional liberal bilaterals in Europe appeared dim.¹⁰⁷ Although European nations favored liberalization, no consensus existed on the degree of liberalization or the methods that should be employed to achieve it.

Additionally, European states were reluctant to create a regime which might cause their state airline to fail. IATA Director George R. Besse notes that airlines are "tools of prestige, of privilege. There is a social and political order connected with running an airline, and like it or not, that's the way it is."¹⁰⁸ Moreover, the perception that air transit is in the nature of a public utility is widespread. For example, Austria and AEA took the position that while some liberalization is in order, airlines are essentially public utilities.¹⁰⁹ Karl-Heinz Neumeister observed:

It remains a fact that scheduled air transport is a form of public utility. That means the airline has certain responsibilities, one of which is to provide a service according to a

¹⁰² WHEATCROFT & LIPMAN, *supra* note 78, at 68.

¹⁰³ *Id.*

¹⁰⁴ *Id.* at 103.

¹⁰⁵ DEMPSEY, *supra* note 1, at 103.

¹⁰⁶ *Air Cartel*, *supra* note 1, at 23, 31.

¹⁰⁷ DEMPSEY, *supra* note 1, at 103-04.

¹⁰⁸ *Deregulation Stall*, *supra* note 30, at 44.

¹⁰⁹ *Increased Liberalization*, *supra* note 10, at 36.

published schedule, irrespective of whether there is sufficient demand for a given flight. With such obligations, it is quite normal to receive compensation in return. This is usually expressed by limiting the number of airlines on a route.¹¹⁰

Despite the obstacles to liberalization, the increasing number of liberal bilateral agreements is evidence that the European states are heading toward a more free market-oriented air transport system. In this light, it is important to examine EC competition rules and air transport policy. For under the EEC Treaty, EC law takes precedence over the national laws of Member States.¹¹¹

III. THE EEC TREATY: COMPETITION RULES AND AIR TRANSPORT POLICY

In 1957, the EEC Treaty established the Community, and with the addition of Spain and Portugal on January 1, 1986, the EC grew to twelve Member States.¹¹² The Treaty is essentially the constitution of the EC. The twin goals of the Community, as described by Peter Sutherland, former EC Commissioner for Competition, are "the completion of a genuine, barrier-free internal market and the restoration and enhancement of the competitiveness of European industry."¹¹³

The EEC Treaty bound together the nations of western Europe for the purposes of creating an economically efficient market and restricting anticompetitive behavior on the part of Member States.¹¹⁴ The goals of the Treaty included harmonious development and expansion of economic activities, increased economic stability, an improved standard of living, and closer relations between Member States.¹¹⁵ To accomplish its goals, Article 3(e)

¹¹⁰ *Id.*

¹¹¹ *Don't Take Europa to Brussels, They Cry*, *ECONOMIST*, Nov. 8, 1986, at 55 [hereinafter *Don't Take Europa*].

¹¹² Henri A. Wassenbergh, *Regulatory Reform—A Challenge to Inter-Governmental Civil Aviation Conferences*, 11 *AIR L.* 31, 40 n.26 (1986). France, West Germany, Italy, Belgium, the Netherlands, and Luxembourg were the original Member States. On January 1, 1973, Denmark, Ireland, and the United Kingdom joined the EC. Greece joined in 1981. The EC saw the addition of a larger Germany when West Germany and East Germany reunified in 1990. Turkey, Austria, Malta, and Cyprus have applied for membership. Attempts to integrate the EC within its 1992 target, however, have put expanded membership on hold.

¹¹³ Peter D. Sutherland, *The Competition Policy of the European Community*, 30 *ST. LOUIS U. L.J.* 149, 154 (1985).

¹¹⁴ EEC TREATY art. 3.

¹¹⁵ *Id.* at art. 2.

of the Treaty directs the EC to adopt, *inter alia*, a common transport policy.¹¹⁶

The EEC Treaty was enacted with the presumption that "national economies can be unified only if there is an efficient system for moving people and goods."¹¹⁷ The importance of transport in Europe is evidenced by the fact that the industry accounts for more than 7 percent of Europe's Gross National Product. It employs between 5.4 and 7.3 percent of the working population, and 11 percent and 40 percent of private and public investment, respectively.¹¹⁸ The drafters of the EEC Treaty were cognizant of the integrating function of air transport as well as its unique problems. Thus, they gave special consideration to air transport under the EEC Treaty. A major consideration was the coordination of sovereign rights both inside and outside the boundaries of the EC.¹¹⁹

In 1962, the Council specifically exempted transportation from the competition rules of Articles 85 and 86 of the EEC Treaty.¹²⁰ The solicitude for transportation arose, to a significant extent, because of longstanding bilateral and multilateral airline agreements among Member States. Examples include the Chicago Convention on International Civil Aviation of 1944 and the numerous bilateral air transport agreements between various European nations.¹²¹ These agreements concerned international airline coordination which already existed at the EEC Treaty's adoption in 1957. The EEC Treaty drafters were unable to design a policy both benefiting the EC and maintaining the integrity of extra-Community treaties.¹²² Consequently, air transport policy made little headway during the EC's first two decades. Most governments were satisfied with the status quo.¹²³

¹¹⁶ *Id.* at art. 3(e).

¹¹⁷ *Role of Transport in EEC*, 1 Common Mkt. Rep. (CCH) ¶ 1802 (1974).

¹¹⁸ *Report Drawn Up on Behalf of the Committee of Transport on the Judgment of the Court of Justice on the Common Transport Policy and the Council's Obligation in Relation Thereto*, 1985-1986 EUR. PARL. DOC. (A 2-84/85/B) 15 (1985) [hereinafter *Report*].

¹¹⁹ 1980-1981 EUR. PARL. DOC. (No. 469) 14 (1980).

¹²⁰ N. Argyris, *The EEC Rules of Competition and the Air Transport Sector*, 26 COMMON MKT. L. REV. 5, 6 (1989).

¹²¹ See *Turbulence*, *supra* note 9, at 307-08, 314-18, 325-42.

¹²² *Transport by Sea or Air*, 1 Common Mkt. Rep. (CCH) ¶ 1945.05 (1974) ("[w]ith respect to transport by sea and air, Article 84(2) makes the applicability of the Title 'Transport' dependent upon a unanimous Council decision").

¹²³ Sorensen, *supra* note 9, at 3.

The importance of transportation in the overall scheme of the EC, however, was underscored by separate provisions in the EEC Treaty for a common transport policy.¹²⁴ Treaty Article 84(2) gave special consideration to air transportation, providing: "The Council may, acting unanimously decide whether, to what extent and by what procedure appropriate provisions may be laid down for sea and air transport."¹²⁵ A common transport policy for rail, roads, and inland waterways was adopted in 1968.¹²⁶ A formal policy for sea transport was not adopted until 1986.¹²⁷

In view of the widely perceived shortcomings in the EC's approach to air transport policies and procedures, the debate turned to the competition rules of Articles 85 and 86 of the EEC Treaty. The applicability of these rules to air transport within the EC has been a central issue since the mid-1970s.¹²⁸ Even though the ECJ declared in the 1986 *Nouvelles Frontières* case that the competition rules applied to air transport, nevertheless significant questions remained unanswered.¹²⁹ While the ECJ concluded that the competition rules would be applied to air transport, the questions became where, when, and how.¹³⁰

Competition was intended to play an essential role in achieving the objectives of the EC.¹³¹ In order to diminish barriers to the free flow of commerce, the drafters included Articles 85 and 86, which prohibited anticompetitive activities.¹³² The Commission has subsequently declared that competition is the best motivator of economic activity and is essential for the improvement of both living standards and employment prospects.¹³³ In support of these objectives, Article 2 of the EEC Treaty incorporates the goal of efficient economic integration of the Community.¹³⁴ Furthermore, Article 3(f) calls for the implementation of a system which assures that competition will not be distorted within the Common Market.¹³⁵

¹²⁴ *Common Transport Policy*, 1 Common Mkt. Rep. (CCH) ¶ 1812 (1974).

¹²⁵ EEC TREATY art. 84(2).

¹²⁶ Council Regulation 1017/68, 1968 O.J. (L 175) 1.

¹²⁷ Council Regulation 4056/86, 1986 O.J. (L 378) 4.

¹²⁸ WHEATCROFT & LIPMAN, *supra* note 78, at 55-56.

¹²⁹ *Id.*

¹³⁰ WHEATCROFT & LIPMAN, *supra* note 78, at 56.

¹³¹ DEMPSEY, *supra* note 1, at 242.

¹³² EEC TREATY arts. 85, 86.

¹³³ P.S.R.F. MATHIJSEN, A GUIDE TO EUROPEAN COMMUNITY LAW 167 (4th ed. 1985).

¹³⁴ EEC TREATY art. 2.

¹³⁵ *Id.* at art. 3. Activities in Article 3 which are pertinent to competition include:

The competition rules generally aim to prevent the introduction of obstacles to free trade; this does not mean, however, that the Community policy on competition is basically restrictive. Indeed, cooperation among enterprises is permitted and even encouraged where the effect is to promote competition both inside and outside of the Community.¹³⁶ The primary thrust of the EC competition laws is to maintain a "beneficial, unified economy."¹³⁷ Unlike the United States, the EC competition laws are aimed only at anticompetitive practices that produce abusive and harmful effects in the marketplace.¹³⁸

Under the EEC Treaty and subsequent EC agreements, Community law, including competition law, takes precedence over the law of the individual Member States. Consequently, the governments of those states must bring their laws into conformity with the mandates and decisions of the EC ministers and the decisions of the ECJ.¹³⁹ The Commission may exercise considerable jurisdiction in enforcing the competition rules of the EEC Treaty.¹⁴⁰

Article 85(1) prohibits as "incompatible with the Common Market . . . any agreements between enterprises, any decisions by associations of enterprises and any concerted practices which are likely to affect trade between the Member States and which have as their object or result the prevention, restriction or distortion of competition within the Common Market"¹⁴¹ In order to

-
- (e) the inauguration of a common transport policy;
 - (f) the establishment of a system ensuring the competition shall not be distorted in the Common Market;
 - (g) the application of procedures which shall make it possible to co-ordinate the economic policies of Member States and to remedy disequilibria in their balances of payments;
 - (h) the approximation of their respective municipal law to the extent necessary for the functioning of the Common Market.

Id.; see also MATHIJSEN, *supra* note 133, at 179.

¹³⁶ MATHIJSEN, *supra* note 133, at 168.

¹³⁷ DEMPSEY, *supra* note 1, at 241-55.

¹³⁸ *Id.*

¹³⁹ *Id.*; *Don't Take Europa*, *supra* note 111, at 55. National courts of Member States may enforce the competition laws of the EEC Treaty. The Commission is encouraging this route to reduce its increasing workload. Only national courts may award damages in private litigation for injuries suffered through infringement of Articles 85 and 86. Compare EEC TREATY art. 177; CCH *Commentary: Preliminary Rulings*, 3 Common Mkt. Rep. (CCH) ¶ 4656 (1978) (preliminary rulings by Court of Justice) with EEC TREATY art. 183; *Article 181*, 3 Common Mkt. Rep. (CCH) ¶ 4675 (1978) (jurisdiction of national courts).

¹⁴⁰ DEMPSEY, *supra* note 1, at 242.

¹⁴¹ EEC TREATY art. 85(1). Article 85(1) "in particular" prohibits practices which, aside from satisfying the other criteria, consist of:

fall within these prohibitions, agreements having proscribed objects must be cast in the form of a legally binding contract. If such a binding agreement exists, a violation has occurred even if it is not implemented. A violation of the EEC Treaty may also exist if informal agreements are followed by certain practices. Impermissible binding agreements or practices may also be inferred from circumstantial evidence, including behavior having an anticompetitive effect.¹⁴² It is important to note, however, that an anticompetitive effect alone, such as a parallel price increase, does not establish the existence of a prohibited agreement. Rather, such conduct may be the result of independent decisions or other factors not reflecting violations of the competition rules.¹⁴³

The competition rules apply only to practices that affect trade among Member States.¹⁴⁴ In an agreement between a Member State and a non-EC nation, anticompetitive provisions would not be prohibited unless they had an anticompetitive object or effect within the EC.¹⁴⁵ Furthermore, “[a]n agreement ‘may’ affect trade when it ‘is capable of constituting a threat, either direct or indirect, actual or potential, to freedom of trade between Member States in a manner which might harm the attainment of the objectives of a single market between States.’”¹⁴⁶ Given that the prohibitions extend to agreements that “affect” trade, even agreements which have the effect of increasing the volume of trade, or which do not involve imports or exports, may be prohibited.¹⁴⁷ The ECJ has indicated that in order to constitute an impermis-

(a) the direct or indirect fixing of purchase or selling prices or of any other trading conditions;

(b) the limitation or control of production, markets, technical development or investment;

(c) market-sharing or the sharing of sources supply;

(d) the application to parties to transactions of unequal terms in respect of equivalent supplies, thereby placing them at a competitive disadvantage; or

(e) the subjecting of the conclusion of a contract to the acceptance by a party of additional supplies, which, either by their nature or according to commercial usage, have no connection with the subject of such contract.

Id.

¹⁴² MATHIJSEN, *supra* note 133, at 169–70.

¹⁴³ *Id.* at 170.

¹⁴⁴ *Id.* at 172.

¹⁴⁵ *Id.* at 172–74.

¹⁴⁶ *Id.* at 172 (quoting Joined Cases 56 & 58/64, *Etablissements Consten, S.A.R.L. v. Commission*, 1966 E.C.R. 299, 341).

¹⁴⁷ *Id.* at 172 n.17, 174–75.

sible "distorting," competition "must be prevented, restricted or distorted to an *appreciable* extent."¹⁴⁸

Under Article 85(2), any agreements or decisions prohibited by the EEC Treaty are automatically void.¹⁴⁹ With respect to entire agreements, however, only those clauses or provisions found to be in violation are void.¹⁵⁰ The remainder of the agreements may remain in effect.

The Commission may grant declarations of inapplicability of the operation of Article 85(1).¹⁵¹ Such exemptions may be granted only after the Commission has been notified and the following four conditions, specified in Article 85(3), are satisfied:

- (1) The agreement must contribute to improving the production or distribution of goods or to promoting technical and economic progress;
- (2) consumers must get a fair share of the resulting benefit;
- (3) the agreement may not impose restrictions which are not indispensable for the objectives under (1) and (2); and
- (4) the agreement may not afford the parties the possibility of eliminating competition in respect of a substantial part of the products in question.¹⁵²

In applying the Article 85(3) conditions, the Commission and the ECJ have found the following types of agreements likely to be prohibited:

- a) agreements relating to prices and conditions of sale; b) limitations on markets and production; c) agreements whereby a vendor agrees not to compete within the market of the purchaser; d) exclusive dealing agreements, such as supply agreements; collective exclusive dealings; and e) joint purchasing and joint selling agreements.¹⁵³

Practices such as tariff agreements, pooling agreements, and capacity and territorial restrictions, raise Article 85 questions even under the most liberal bilateral agreements.

¹⁴⁸ *Id.* at 173 (emphasis in original).

¹⁴⁹ *Id.* at 175.

¹⁵⁰ *Id.* at 173. Exceptions to the "automatically void" provision exist for agreements executed before March 13, 1962, when Regulation 17, the first regulation implementing Articles 85 and 86, was enacted. *Id.* at 175. Even the so-called "old" agreements, however, may be voided if they violate the Treaty. *Id.* at 175-76.

¹⁵¹ *Id.* at 176.

¹⁵² See EEC TREATY art. 85(3).

¹⁵³ MATHIJSEN, *supra* note 133, at 177-78; EEC TREATY art. 85(3). See generally Argyris, *supra* note 120, at 9.

Two EC regulations have been promulgated to implement Article 85(3).¹⁵⁴ They permit “consultations” between airlines to prepare joint tariff proposals subject to the approval of the aeronautical authorities of Member States. These consultations are valid, provided, *inter alia*, the following conditions are met: (1) that participation in the consultations is voluntary and open to any carrier which operates or proposes to operate on the route in question; (2) that the resulting tariff is not binding—thereby preserving the carriers’ right of independent action; (3) that the tariff does not discriminate on the basis of the passengers’ nationality or residence; and (4) that discussions not include capacity or agent remuneration issues.¹⁵⁵

Article 86, which complements Article 85, forbids abuse of a dominant position enjoyed individually or collectively by a group of “undertakings,”¹⁵⁶ such as business firms. “Dominant position” indicates a position of economic strength allowing the possessor to “behave to an appreciable extent independently of its competitors, customers and ultimately of the consumers.”¹⁵⁷ Whether an undertaking or group of undertakings enjoys such a position must be established in view of relevant product and geographical markets and the market share possessed.¹⁵⁸ Although the dominant position must be over a substantial portion of the Common Market, the territory of a single Member State may be sufficient for Article 86 to apply. Most European national airlines hold

¹⁵⁴ Council Regulation 3976/87, 1987 O.J. (L 374) 9; Commission Regulation 2671/88, 1988 O.J. (L 239) 9.

¹⁵⁵ Commission Regulation 2671/88, *supra* note 154.

¹⁵⁶ MATHIJSEN, *supra* note 133, at 179. Article 86 states the prohibitions are aimed at abuse of a dominant position “within the Common Market or within a *substantial* part of it” which affects trade between Member States. EEC TREATY art. 86 (emphasis added); see also Article 86, 2 Common Mkt. Rep. (CCH) ¶ 2101 (1978) (abuse of dominant position). The Article goes on to state:

Such improper practices may, in particular, consist [of]:

- (a) the direct or indirect imposition of any inequitable purchase or selling prices or of any other inequitable trading conditions;
- (b) the limitation of production, markets or technical development to the prejudice of consumers;
- (c) the application to parties to transactions of unequal terms in respect of equivalent supplies, thereby placing them at a competitive disadvantage; or
- (d) the subjecting of the conclusion of a contract to the acceptance, by a party, of additional supplies which, either by their nature or according to commercial usage, have no connection with the subject of such contract.

EEC TREATY art. 86. Compare these latter “in particular” provisions with those in Article 85(1), *supra* note 141.

¹⁵⁷ MATHIJSEN, *supra* note 133, at 179–80; DEMPSEY, *supra* note 1, at 248.

¹⁵⁸ MATHIJSEN, *supra* note 133, at 180–81; DEMPSEY, *supra* note 1, at 248.

dominant positions in their own countries.¹⁵⁹ Dominance, however, is established not by size alone but rather by considering a number of factors.¹⁶⁰

The concept of "abuse" of a dominant position refers to an adverse impact on competition.¹⁶¹ Any activity which "interferes with one of the basic freedoms or the free choice of purchasers or consumers or freedom of access to business, must be viewed as limiting competition and, therefore, as an 'abuse.'"¹⁶² The methods used to affect competition are irrelevant. Activities which are "detrimental to production or sales, to purchasers or consumers, and changes to the structure of an undertaking which lead to competition being seriously disturbed in a substantial part of the common market, are prohibited by Article 86."¹⁶³ The mere existence of a monopoly does not establish a violation of Article 86. Rather, only practices detrimental to consumers and the economy bring the proscriptions into play.¹⁶⁴ For example, a national airline would likely be held to occupy a sufficiently dominant position over a sufficiently large part of the Common Market—its own country—to implicate Article 86.¹⁶⁵ Price-fixing and capacity limitation agreements by firms in monopoly positions might be considered violations of Article 86.¹⁶⁶ Therefore, an argument exists that airline fare-setting, capacity limitations, and other agreements and practices may violate Article 86.

In distinguishing Articles 85 and 86, it is important to note that unlike Article 85, Article 86 does not provide for exemptions.¹⁶⁷ Under Article 2 of Regulation 17, the Commission may grant a "negative clearance," which merely certifies that because it perceives no violation, the Commission sees no reason to proceed against the entities involved.¹⁶⁸ This, however, does not confer "absolute immunity." The Commission still has power to de-

¹⁵⁹ DEMPSEY, *supra* note 1, at 248.

¹⁶⁰ MATHIJSEN, *supra* note 133, at 181.

¹⁶¹ *Id.*

¹⁶² *Id.*

¹⁶³ *Id.* at 179.

¹⁶⁴ DEMPSEY, *supra* note 1, at 248.

¹⁶⁵ *Unlawful Practices by Dominant Concerns, Application of Article 86*, 2 Common Mkt. Rep. (CCH) ¶ 2111 (1978) (CCH Explanation) [hereinafter *Unlawful Practices*].

¹⁶⁶ *Id.*

¹⁶⁷ DEMPSEY, *supra* note 1, at 248.

¹⁶⁸ *Id.* at 249 n.61.

termine that a violation exists and to proceed with enforcement.¹⁶⁹

Direct application of the competition rules could result in the prohibition of many current European airline practices under both Articles 85 and 86. Indeed, the Commission threatened to take action on its own if the Council failed to act on a common air transport policy.¹⁷⁰ A complete understanding of the competition rules as they affect air transport requires further review of the governing institutions of the EC and the actions they have taken in response to air transport issues.

IV. INSTITUTIONS OF THE EUROPEAN COMMUNITY AND THE DEVELOPMENT OF AIR TRANSPORT POLICY

The governing institutions of the EEC Treaty were created to ensure proper compliance and implementation of its provisions.¹⁷¹ The four governing bodies of the EC—the Council, the Commission, Parliament, and the ECJ—have devoted considerable attention to the question of how the EEC Treaty should be applied to air transport.

A. *Parliament*

Meeting in Strasbourg, France, or in Brussels, Belgium, Parliament comprises 518 members who are elected directly by the citizens of the twelve Member States.¹⁷² Members of Parliament are expected to act for the benefit of the entire EC, rather than for the benefit of their respective governments.¹⁷³ Parliament has the duty of advising the Council on issues of importance to the development of the EC.¹⁷⁴ As a matter of procedure, the Commission issues recommendations to the Council which are subsequently referred to Parliament for further comment and recommendation. Parliament generally comments on the potential legal and political implications of a proposed regulation.¹⁷⁵

¹⁶⁹ *Id.* at 249; *Unlawful Practices*, *supra* note 165, ¶ 2111.

¹⁷⁰ DEMPSEY, *supra* note 1, at 250.

¹⁷¹ HENKEN, *supra* note 16, at 1077.

¹⁷² *Number and Designation of Delegates*, 3 Common Mkt. Rep. (CCH) ¶ 4306 (1987).

¹⁷³ *Advisory and Supervisory Powers of Parliament*, 3 Common Mkt. Rep. (CCH) ¶ 4302 (1987).

¹⁷⁴ *Id.*

¹⁷⁵ *See generally id.*

Parliament has devoted years of effort to bringing about a comprehensive and coherent common transport policy.¹⁷⁶ Parliament's stated priorities include bringing the people of Europe closer together, boosting intra-Community trade, encouraging economic growth, and reducing unemployment. It also aims to open outlying regions, help bridge the gap between the prosperous and impoverished regions, and remove congestion from certain overcrowded urban centers. Parliament envisions achievement of its objectives through taxpayer financing of construction of new major routes and infrastructure and the elimination of bottlenecks in existing route networks.¹⁷⁷

Parliament has approved a very cautious approach to deregulation. During the inaugural period of liberalization, Parliament's advisory decisions allowed only limited exemptions to the competition rules. A parliamentary report states that either nation served by a disputed airline route should unilaterally be able to block new low fares on that particular route.¹⁷⁸

B. *The European Court of Justice*

Sitting in Luxembourg, the ECJ comprises eleven judges who are appointed for terms of six years by "common accord" of the Member States.¹⁷⁹ The ECJ is the highest court in the Community. It renders decisions on the application of the EEC Treaty to Member States by interpreting and enforcing its provisions.¹⁸⁰

Several problems arise when the Court interprets the EEC Treaty and, in effect, changes Community policy in the absence of governing regulations promulgated by the Council. In such situations, Member States would have to administer competition laws without the guidance of regulations. Consequently, laws would not be applied uniformly because Member States would be free to interpret them individually. Furthermore, competition laws would be invoked only when convenient or acceptable to Member States, thereby only marginally stimulating competi-

¹⁷⁶ *Report, supra* note 118, at 7.

¹⁷⁷ *Id.* at 21.

¹⁷⁸ *Europeans Advise Slow Deregulation Approach*, AV. WK. & SPACE TECH., Sept. 23, 1985, at 39.

¹⁷⁹ *CCH Commentary: Judges and Chambers of the Court of Justice*, 3 Common Mkt. Rep. (CCH) ¶ 4606 (1981); *Article 168 [Registrar of the Court of Justice]*, 3 Common Mkt. Rep. (CCH) ¶ 4611 (1981).

¹⁸⁰ *Introduction*, 3 Common Mkt. Rep. (CCH) ¶ 4600 (1981).

tion.¹⁸¹ The inconsistent application of competition laws would also adversely impact the EEC Treaty's goal of an economic and harmonious transport system.¹⁸² Moreover, a decision applying the competition laws to the airline industry would interfere with the Council's authority to adopt official policy for the economic harmonization of air transport.¹⁸³

1. French Seamen's Case

The Court has, however, rendered decisions of great importance holding that the competition laws of the EEC Treaty do apply to air transport, and that the Council has a duty under the Treaty to formulate a coordinated transport policy for the Community. For example, in the 1974 *French Seamen's* case, the Court pronounced that the general rules of the EEC Treaty, including nondiscrimination on national grounds, right of establishment, competition, mobility of labor, and equal pay, though unenforceable under existing regulations, apply to transport.¹⁸⁴ This holding violated the plain meaning and intent of Article 84(2), which provides that the Council must adopt rules before EEC Treaty provisions may be applicable.

2. Transport Policy Decision

The Court rendered another important decision concerning European transportation in response to a complaint brought against the Council by Parliament.¹⁸⁵ In January 1983, Parliament took the unusual step of bringing an action against the Council in the ECJ under Article 175, seeking a declaration that the Council had failed to act in the field of common transport policy.¹⁸⁶ Parliament also asked for a declaration that the Council had breached the EEC Treaty by failing to render a decision on sixteen specific proposals relating to transport submitted to it by

¹⁸¹ Letter from Knut Hammarskjold, *supra* note 44.

¹⁸² See EEC TREATY arts. 74–84.

¹⁸³ *Id.* at art. 84(2).

¹⁸⁴ Sorensen, *supra* note 9, at 3; Case 167/73, *Commission v. France*, 1974 E.C.R. 359.

¹⁸⁵ European Parliament Committee on Transport, *Notice to Members Concerning the Judgment of the Court of Justice of the European Communities of 22 May 1985 in Case 13/83, European Parliament v. Council of the European Communities: Common Transport Policy—Obligations of the Council*, June 7, 1985, at 2 [hereinafter *Obligations of Council*].

¹⁸⁶ Fran Pasetti Bombardella, *Analysis of the Judgment of the Court of Justice of 22 May 1985—Common Transport Policy—Council's Obligations*, June 14, 1985, at 1.

the Commission.¹⁸⁷ Parliament insisted that the establishment of a common transport policy is a requirement flowing directly from the EEC Treaty.¹⁸⁸

In the *Transport Policy Decision*, the Court held that a complaint brought on the grounds of failure to act is admissible.¹⁸⁹ This was the first time in EC history that the Court had so held.¹⁹⁰ The Court concluded that the Council failed to act with regard to freedom to provide services in the field of international transport. Furthermore, the Court found that the Council had failed to fix conditions under which nonresident carriers may operate transport services within a Member State. The Council, in fact, breached the EEC Treaty by not taking measures necessary for these purposes before the expiration of the transitional period on December 31, 1969.¹⁹¹ Pursuant to the EEC Treaty, however,

¹⁸⁷ *Obligations of Council*, *supra* note 185, at 2.

¹⁸⁸ European Parliament Committee on Transport, *Notice to Members: Proceedings Against the Council for Failure to Act*, May 31, 1985, at 8 [hereinafter *Proceedings*]. Parliament argued that the Council's inaction violated Articles 3(3), 61, 74, 75, and 84 of the EEC Treaty.

¹⁸⁹ Florus Wijsenbeek, *European Parliament Committee on Legal Affairs and Citizens' Rights Opinion for the Committee on Transport on the Report on the Judgment of the Court of Justice on the Common Transport Policy and the Council's Obligation in Relations Thereto*, June 28, 1985, at 3; Case 13/83, *European Parliament v. Council*, 1985 E.C.R. 1513.

¹⁹⁰ See *Report*, *supra* note 118, at 12 (first time Council found guilty of failure to act); see also Wijsenbeek, *supra* note 189, at 3 (Parliament strengthened by fact that action for failure to act was admissible).

The Court reasoned that the institutional position of a body, as intended by the Treaty, particularly Article 4(1), would be prejudiced if it were restricted in the exercise of that power. The fact that the Parliament exercised political control over the Commission, and, to a certain extent, the Council, "does not affect the interpretation of the provisions of the Treaty governing the legal remedies available to the institutions." See Bombardella, *supra* note 186, at 2.

The Court found a close connection between freedom to provide services under Article 75(1)(a) and (b) and the adoption of a common transport policy. Furthermore, Articles 59 and 60 of the Treaty define the scope of the Council's obligation to introduce freedom to provide services. See *Obligations of Council*, *supra* note 185, at 6. The Court held that the Council does not have discretion in applying Articles 59 and 60. Articles 59, 60, and 61, in conjunction with Article 75(1)(a) and (b), clearly indicate that discretion may be exercised only with regard to the details of how the objective will be attained. *Id.* at 7.

The Court's decision confirmed that there was not a coherent body of rules which could be described as a common transport policy within the meaning of Articles 74 and 75 of the Treaty, but that this did not in all aspects constitute a failure to act actionable under Article 175.

¹⁹¹ *Obligations of Council*, *supra* note 185, at 7. The Court qualified its grant of review by holding that the failure to act must relate to measures which the Council has not adopted and which are specific enough for the judgment to be executed under Article 176. In other words, Parliament must show that the Council has completely failed to act where there is a specific directive requiring action. Furthermore, the measures forming

the Council retains the right to determine the objectives and means of attaining a common transport policy in accordance with the EEC Treaty's procedural rules. The Council has wide discretion with regard to the substance and organization of the common transport policy, limited only by procedural requirements and specific time limits.¹⁹²

The significance of this decision may best be described as an official acknowledgement that the Council failed in its duty to provide a common transport policy. Furthermore, the decision allows other EC governmental bodies to obtain judicial review of the Council's activities. While the decision explicitly addressed only the Council's obligations to develop a surface transport policy, its implications for air transport are manifest.

3. Olympic Airways

The Commission took a strong position on the question of whether the competition laws may be applied directly to sea and air transport in the *Association des Compagnies Aeriennes de la Communauté Européenne* (ACE) complaint against Olympic Airlines.¹⁹³ ACE's charges against Olympic followed in the wake of charges against the Belgian airline Sabena, which was accused of receiving illegal government loan guarantees and subsidizing depreciation charges and interest payments. The complaint alleged that Olym-

the subject matter of the dispute must be sufficiently defined to allow the Court to appraise the legality of their adoption or nonadoption. See *Bombardella*, *supra* note 186, at 2. If, however, Parliament had specified which measures the Council should have adopted in the common transport policy, it would have risked having the case dismissed as an encroachment on the Council's discretion. *Proceedings*, *supra* note 188, at 6.

As to the objective difficulties which, according to the Council, prevent progress toward a common transport policy, the Court held them irrelevant in the context of disputes under Article 175. Article 175 makes no concessions to the degree of difficulty involved for the institution to fulfill its obligation. The Council is obligated to make a decision despite the difficulty it may encounter.

¹⁹² *Proceedings*, *supra* note 188, at 9. Thus, as a procedural matter, if the Council is required to adopt a certain measure by a qualified majority, as in Article 75, it cannot justify its failure to act because of a lack of unanimity. See *Bombardella*, *supra* note 186, at 3.

The Council is also required to act on the measures specified by the Court within a "reasonable period." *Id.* The Court's determination that the Council must act within a "reasonable" time is not sufficiently clear. *Proceedings*, *supra* note 188, at 7. Nor has the Treaty set a time limit as to when action must occur. But a prolonged failure to act would presumably have been a further infringement of the Treaty. See *Bombardella*, *supra* note 186, at 3.

¹⁹³ *DEMPSEY*, *supra* note 1, at 246-49.

pic had received government subsidies in the form of landing fee exemptions at Greek airports. Furthermore, ACE accused Olympic of abusing its "dominant position" by creating a monopoly over baggage handling at Greek airports. ACE claimed that allowing one airline to avoid paying landing fees "distorts or threatens to distort competition."¹⁹⁴ ACE's complaint charged that the resultant market distortion violated the free and equal trading opportunities mandate of Article 92(1). ACE also alleged that the subsidies violated Article 7, which prohibits discrimination on the basis of nationality.¹⁹⁵ The Commission held that, "[t]here is no legal basis for claiming, as Olympic Airways claims, that Article 85 and 86 do not apply to air transport."¹⁹⁶

4. Nouvelles Frontières

The ECJ's *Nouvelles Frontières* opinion, decided in April 1986, was of particular relevance to air transport. It considered whether Member States have the right to regulate the price of airline tickets sold within their borders.¹⁹⁷ The ECJ answered certified questions from a French court concerning the applicability of EEC Treaty competition rules to IATA price-fixing agreements by French airlines.¹⁹⁸ *Nouvelles Frontières*, a French travel agency, was selling tickets at fares that had not been approved by the French government under the French Civil Aviation Code.¹⁹⁹

The ECJ first held that, absent specific language within the EEC Treaty, air transport was "subject to the general rules of the Treaty, including the competition rules."²⁰⁰ Professor Peter Haanappel of McGill University noted, "[i]n essence, the Court ruled that it is contrary to . . . the Treaty to approve air tariffs where these tariffs are the result of an agreement, a decision of [a trade

¹⁹⁴ *EEC Claims Greek Airline Received Illegal Subsidies*, AV. WK. & SPACE TECH., Jan. 17, 1983, at 34.

¹⁹⁵ *Id.*

¹⁹⁶ Commission Decision of Jan. 23, 1985, 1985 O.J. (L 46) 51, 52; DEMPSEY, *supra* note 1, at 104-06.

¹⁹⁷ Michael Feazel, *Liberalization Policies at Issue in Ruling in French Fare Case*, AV. WK. & SPACE TECH., July 15, 1985, at 28.

¹⁹⁸ See generally Henri A. Wassenbergh, *The 'Nouvelles Frontières' Case*, 11 AIR L. 161 (1986).

¹⁹⁹ P.P.C. Haanappel, *Colloquium 'Nouvelles Frontières'*, State University of Leyden, the Netherlands, 11 AIR L. 181, 182 (1986).

²⁰⁰ *Ministère Public v. Asjes (Nouvelles Frontières)*, 1986 E.C.R. 65, 72 [1985-1986 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 14,287, at 16,772, 16,778 (1986) [hereinafter *Nouvelles Frontières*].

association] or a concerted practice itself contrary to Article 85.”²⁰¹ The ECJ then concluded that absent specific regulations governing air transport adopted by the Council under Article 87, it was up to the competent “authorities in Member States” under Article 88 to apply the competition rules of the EEC Treaty to agreements concerning the air transport industry. Alternatively, the Court held that the Commission could issue a “reasoned decision” under Article 89.²⁰² Both options, however, would open a floodgate of litigation in the national courts of Member States.²⁰³

Nouvelles Frontières was a significant expansion of the power the Commission could wield against anticompetitive practices among European airlines. *Nouvelles Frontières*, however, while a philosophical victory for those seeking greater liberalization, was, in fact, a practical defeat. Although the ECJ found that Articles 85 and 86 of the EEC Treaty specifically apply to air transport, it created a right without a remedy until either the Council adopted regulations or the Commission issued a reasoned decision. Nonetheless, the decision intensified the pressure on the Council to promulgate regulations discouraging future litigation.

5. Ahmed Saeed

The ECJ handed down the important decision of *Ahmed Saeed* on April 11, 1989.²⁰⁴ The Association for the Protection Against Unfair Competition brought the case against two Frankfurt travel agencies before a West German court. The agencies were selling airline tickets to West German nationals for flights ostensibly beginning in, for example, Lisbon, Portugal via Frankfurt and beyond. The passengers boarded in Frankfurt, discarding the Lisbon-Frankfurt ticket coupon—in violation of West German law—to take advantage of air fares which were 60 percent less than those approved by the West German government. The High Court of the Federal Republic of Germany submitted the case on certiorari to the ECJ asking for a preliminary ruling as to: (1) whether airline tariff agreements are void as a violation of Article 85 of the EEC Treaty, even if neither a Member State (under

²⁰¹ Haanappel, *supra* note 199, at 182.

²⁰² *Nouvelles Frontières*, *supra* note 200, at 16,778–80.

²⁰³ See *id.* at 16,780; DEMPSEY, *supra* note 1, at 104–06, 252.

²⁰⁴ Ahmed Saeed Fluereusen and Silver Line Reiseburo v. Zentrale zur Bekämpfung unlauteren Wettbewerbs EV, Case 66/86, reprinted in 38 ZEITSCHRIFT FÜR LUFT-UND WELTRAUMRECHT [ALW] 124 (1989) [hereinafter Ahmed Saeed].

Article 88) nor the Commission (under Article 89(2)) has declared them incompatible with Article 85; (2) whether such tariffs constitute an abuse of a dominant position within the meaning of Article 86; and (3) whether the approval of such tariffs by a Member State is incompatible with Articles 5 and 90 of the EEC Treaty, even where the Commission has not objected to such tariff approval (under Article 90(3)). After the initial hearing of the case, but before final judgment, the Council adopted its First Package of Liberalization. In response, the Commission adopted regulations which are discussed below. The ECJ then reopened the case to assess the impact of these developments.

The ECJ found that Article 85 was directly applicable to intra-Community tariff agreements, even in the absence of implementing legislation promulgated by the Member States (under Article 88) or the Commission (under Article 89). This conclusion went beyond the holding in *Nouvelles Frontières*. While tariff "consultations" remained exempt in order for the resulting agreements to be lawful, the Court held that they must comply strictly with the requirements for individual exemptions specified in the Commission's regulations.²⁰⁵ The ECJ also found that Article 86 was directly applicable to air transport, even in the absence of implementing regulations. Thus, fixing scheduled air tariffs on domestic flights, intra-Community flights, or flights to and from the EC would be unlawful if those actions constituted an abuse of a dominant position and if trade between Member States might be affected. The ECJ thus affirmed the *Wood Pulp* case which held the competition rules of the EEC Treaty applicable to agreements made outside the EC that have effect within it.²⁰⁶

Moreover, the Court did not rule out the possibility that Articles 85 and 86 can apply simultaneously.²⁰⁷ Thus, even if an airline qualifies for an individual exemption for a scheduled intra-Community tariff under Article 85(3), it may nevertheless run afoul of the law by abusing a dominant position under Article 86. The Court in *Ahmed Saeed* also addressed the role of Member States, reminding them of their obligation not to approve or encourage

²⁰⁵ Commission Regulation 2671/88, *supra* note 154; Council Regulation 3975/87, 1987 O.J. (L 374) 1.

²⁰⁶ Ludwig Weber, Effect of EEC Air Transport Policy on International Cooperation, Address Before the International Congress on EEC Air Transport, Brussels (May 26, 1989), in *EUROPEAN TRANSPORT LAW* 31 (1989).

²⁰⁷ Joined Cases 89, 104, 114, 116, 117, and 125-129/85, *Re Wood Pulp Cartel: A Ahlstrom Oy and Others v. Commission*, 1988 E.C.R. 5193, 5211, 4 C.M.L.R. 901 (1988).

the consummation of tariff agreements contrary to Articles 85(1) or 86.²⁰⁸

C. *The Commission*

Headquartered in Brussels, the Commission is a nonpartisan body comprising seventeen members—two each from France, Germany, Italy, Spain, and the United Kingdom, and one each from the other Member States—appointed for four-year terms by common agreement of the Member States. Although the Commission acts independently of the Council and the Member States, it works closely with the Council.²⁰⁹ The Commission's duties are primarily executive in nature—to oversee development and ensure that Community development conforms to the EEC Treaty. To fulfill its role, the Commission issues recommendations and advisory opinions to the Council for the consideration and adoption of regulations.²¹⁰ The Commission has specific and critically important jurisdiction over issues surrounding infringement of the EEC Treaty's competition laws.²¹¹

The Commission has been the most active and impatient body in the EC government to pursue a transport policy and the liberalization of airline regulations. While the Commission asserts that it does not believe U.S.-style deregulation would work in Europe, it advocates a gradual change from existing policy, referred to as the "go slow" approach.²¹² For instance, the Commission advocated increased flexibility²¹³ and proposed liberalization of capacity, air fares, and conditions of competition.²¹⁴ Nonetheless, it grew increasingly impatient with the Council's inability or unwillingness to promulgate regulations applying the EEC Treaty's competition rules to air transport.

1. The First Memorandum

Beginning in 1979, the Commission issued several memoranda which put forth possible objectives the Council could adopt. In

²⁰⁸ Ahmed Saeed, *supra* note 204, at 124–30.

²⁰⁹ *Functions of the Commission*, 3 Common Mkt. Rep. (CCH) ¶ 4472 (1987) [hereinafter *Functions of the Commission*]; *Commission Members and Their Duties*, 3 Common Mkt. Rep. ¶ 4482 (1987).

²¹⁰ *Functions of the Commission*, *supra* note 209, ¶ 4472.

²¹¹ EEC TREATY art. 89. Article 89 gives the Commission investigatory powers.

²¹² Sorensen, *supra* note 9, at 6.

²¹³ *Id.*

²¹⁴ *Id.* at 7.

1979, the Commission issued *Memorandum 1* which pointed out several problems with the air transport regime.²¹⁵ Problems included a tendency towards high tariffs due to governmental presence, limited fare flexibility for holidays, and, most importantly, limited possibilities for innovation.

2. The Second Memorandum

In March 1984, the Commission followed with *Memorandum 2*, entitled "Progress Towards the Development of a Community Air Transport Policy."²¹⁶ *Memorandum 2* expanded on the ideas promulgated in *Memorandum 1*.²¹⁷ The aims of *Memorandum 2* were to review the developments since *Memorandum 1*, to propose an overall framework for air transport in the Community, to put forth legislative measures for the Council's adoption, and to outline future Commission work.²¹⁸

a. Policies

The policies of *Memorandum 2* focused on air transport between Member States as an important part of the creation of a Common Market in aviation, and the improvement of the Common Market in general.²¹⁹ The Commission, however, was not oblivious to the impact and importance of international aviation outside the EC. The memorandum recognized the impact of deregulation in the United States, under the Airline Deregulation Act of 1978, and the need to establish a unified Community posture toward international organizations and non-member countries.²²⁰ The Community's major scheduled airlines were earning 40 percent of their revenues in Europe. They earned the remainder of their revenues on routes to other international destinations, especially on intercontinental routes.²²¹ The Commissioners sought to maintain the existing system of regulation and agreement while introducing flexibility and the benefits of competition.²²²

²¹⁵ *Id.* at 6.

²¹⁶ See generally MEMORANDUM 2, *supra* note 19; DEMPSEY, *supra* note 1, at 100-02.

²¹⁷ Sorensen, *supra* note 9, at 5.

²¹⁸ *Id.* at 6.

²¹⁹ MEMORANDUM 2, *supra* note 19, at I.

²²⁰ *Id.* at 12-13.

²²¹ *Id.* at 9.

²²² *Id.* at I.

Memorandum 2 asked Member States to consider proposals to increase competition by restricting the influence of governments on scheduled airline operations and by introducing greater flexibility in route access, designation, capacity, and fares.²²³ The Commission asserted that all of the proposals in *Memorandum 2* were interdependent, and therefore required adoption by both the Council and the Commission and implementation as a package.²²⁴ While the Commission recognized that time would be necessary for discussion and implementation, it discouraged excessive delay and expressly reserved its right of direct action against airline practices in violation of the competition rules.²²⁵

b. *Application*

In what has since become a major issue in liberalization, the Commission proposed applying the competition rules to the scheduled air transport industry.²²⁶ The Commission justified this proposal, two years before *Nouvelles Frontières*, on the basis of ECJ rulings in 1974 and 1978.²²⁷ Opponents argued against adjustments to the European civil aviation regime on the grounds that such changes would result in an unacceptable impact on international aviation outside the Community. The Commission, however, rejected this rationale. Rather, the Commission insisted that such steps would contribute to a "[C]ommunity market in aviation" and the "improvement of the internal market in its wider sense."²²⁸ Nevertheless, the Commission recognized the repercussions of its proposals on the non-Community states of Europe in formulating its proposals.²²⁹ The Commission sought a qualified increase in competitiveness throughout European civil aviation:

[R]ecent years have made it clear that although the present regime has produced an extensive network of aviation services, the rigidities of the system . . . give rise to an increasing degree of public dissatisfaction. This criticism, not all of which is justified, has tended to centre on the civil aviation

²²³ Thaine, *supra* note 68, at 90.

²²⁴ MEMORANDUM 2, *supra* note 19, at III.

²²⁵ *Id.*

²²⁶ Thaine, *supra* note 68, at 95-96.

²²⁷ MEMORANDUM 2, *supra* note 19, at 17. *Nouvelles Frontières* was decided April 30, 1986. See *supra* notes 197-203 and accompanying text.

²²⁸ MEMORANDUM 2, *supra* note 19, at 21.

²²⁹ *Id.* at 22.

services provided within Europe, and the Commission is confirmed in its view that within the Community there is scope for introducing more flexibility and competition into the existing system without destroying it or losing the benefits that it has brought about. Flexibility is not, however, an end in itself. It should be regarded rather as the means to improving the services to the consumer and the profitability of the efficient and enterprising airline.²³⁰

The Commission's qualifications on competition included a recognition of strong state interests in the survival of national airlines and the history of competition in services within the industry, especially with respect to charter airlines.²³¹ In addition, the Commission explicitly acknowledged that the U.S.-style deregulation would not work in Europe,²³² and that direct comparisons of costs and fares between European and similar U.S. routes were invalid. In particular, fuel, air traffic control, and airport charges presented significant cost elements which European airlines could not influence. *Memorandum 2* concluded that air fares in Europe were not unreasonably related to costs, owing in large part to the fact that only 40 percent of total air fare costs are controllable by the airlines. Nevertheless, the Commission believed that changes in procedures related to the fixing of air fares would result in a "wider range of fares." Moreover, the Commission expressed the belief that competitive pressures would ultimately lead to lower air fares.²³³

Memorandum 2 expressed a general preference for an "evolutionary approach"²³⁴ to a more competitive air transport policy. Despite its general adherence to this approach, *Memorandum 2* indicated some signs of the Commission's growing impatience with the state of European air transport. It suggested that any group exemptions from the competition provisions be limited to seven years. Additionally, even though *Memorandum 2* identified exceptions to the prohibitions in Article 85(1) if certain objectives were manifest, such exceptions would expire on December 31, 1991.²³⁵ The Commission reminded the Council of the proposals

²³⁰ *Id.* at 21.

²³¹ *Id.* at 23. Charter traffic within Europe accounts for 60 percent of all air travel. See *Europe's Air Cartel*, *ECONOMIST*, Nov. 1, 1986, at 23, 26.

²³² *MEMORANDUM 2*, *supra* note 19, at 26-27.

²³³ *Id.*

²³⁴ *Id.* at 27.

²³⁵ *Id.* at Annex III C.

it had submitted to it in 1981 calling for directives and regulations, upon which the Council still had not taken action. Finally, the Commission repeatedly reasserted its right to take direct action in certain circumstances against practices in violation of EEC Treaty provisions.²³⁶

The evolutionary approach *Memorandum 2* advocated differed from the more revolutionary policy adopted earlier by the United States. While comprehensive deregulation arguably might have merit in the large, unified market of the United States, conditions in Europe would not justify such an approach.²³⁷ Additionally, at the time, the United States had about twenty major air carriers and the government could take "a relaxed view on the fate of any one of them," in contrast to the nationalized airlines and international character of European aviation.²³⁸ The issue, therefore, was whether the system could be modified sufficiently to meet the needs of the EC while at the same time bringing to bear sufficient competitive pressures for the airlines to "control costs, increase productivity and provide efficient and attractively priced services to the user; and to enable the efficient and enterprising airline to benefit"²³⁹ The Commission stated that the principal measures to be taken to achieve these aims were: (1) Community rules on certain aspects of bilateral agreements between Member States; (2) changes in methods for settlement of air tariffs; and (3) action limiting the effect of commercial and tariff agreements between airlines.²⁴⁰ These, other measures, and Community reaction thereto are discussed below.

i. Bilateral Agreements

The Commission identified scheduling, capacity, revenue sharing, and tariff provisions as the principal features of bilateral or multilateral agreements. Even though the Commission wanted to prevent capacity agreements which were either mandatory or required a strict 50/50 sharing, it recognized that in some cases such agreements were desirable in order to assure service in thin markets. On the other hand, the Commission also recognized that such agreements tended to inure to the detriment of the

²³⁶ *Id.* at Annex III C.2.

²³⁷ *Id.*

²³⁸ *Id.* at 27.

²³⁹ *Id.*

²⁴⁰ *Id.* at 29.

more efficient airline. Consequently, while *Memorandum 2* indicated that Member States should be allowed to enter into capacity agreements, it emphasized that any party should be able to withdraw from them with reasonably short notice.²⁴¹ It also suggested that rigid 50/50 traffic-sharing agreements between Member States be relaxed so that no party is guaranteed a traffic share of more than 25 percent. According to the Commission, "[t]his would . . . permit a greater degree of competition and assure a Member State that its airline would have as a safety net a level of operation below which it could not fall without the consent of its own government."²⁴²

As with capacity sharing, the Commission also recognized that revenue pooling agreements could encourage carriers to operate outside profitable periods. At the same time, however, the Commission recognized that such agreements might also restrict other competition, contrary to Article 85(1). Pooling agreements between airlines were of two basic types: open pools, which distributed revenue based on the capacity offered by each airline; and limited pools, which almost equalized revenue irrespective of which airline generated it. The Commission felt that revenue pools should be permitted in certain limited circumstances, but that open pools would be prohibited. In order to be exempted from the competition rules under Article 85(3), the Commission proposed that such agreements contribute to the improvement of air transportation with a minimum of anti-competitive effect.²⁴³ The Commission's guideline in this area was quite restrictive, however, limiting the transfer of revenue from between airlines to 1 percent of poolable revenues. All other revenue-pooling arrangements would be subject to "specific scrutiny in each case in order to determine whether they would qualify for exemption under Article 85(3)."²⁴⁴

In what was probably its most noteworthy proposal, the Commission recognized that airlines should be as free as possible to determine which tariffs best suited their commercial needs.²⁴⁵ It also recognized that airlines should be able to set tariffs within certain predetermined "zones of reasonableness" without govern-

²⁴¹ *Id.* at 32-33.

²⁴² *Id.*

²⁴³ *Id.* at 33-34.

²⁴⁴ *Id.* at 34.

²⁴⁵ *Id.* at 31.

mental approval. In its "Amended Proposal for a Council Directive," the Commission indicated the minimum acceptable range to be covered within the zones.²⁴⁶ This proposal reflected recent developments in the economic and regulatory environment, such as agreements between the United States and certain ECAC countries for a given number of "reference tariffs," as well as zones of reasonableness.²⁴⁷

Within the zones, airlines could agree on the following three alternatives: (1) airlines would be free to set fares without government interference; (2) proposed fares would take effect unless both countries disapproved; or (3) proposed fares would be subject to country of origin approval. Both governments in bilateral agreements would be expected to consult and agree in setting the zones of reasonableness. In case of a dispute between the two governments concerning fares outside the zone, the country of origin would be able to determine the fare.²⁴⁸

ii. Tariff-Setting

The tariff-setting proposals of *Memorandum 2* also extended to agreements among airlines. The Commission observed that most nations which were members of the International Civil Aviation Organization, which includes virtually the entire global aviation community, recognized such tariff consultations as an essential part of transport policy. These consultations restricted competition, but at the same time had resulted in a "system [which] allowed the provision of reliable, high quality services to the consumer."²⁴⁹ The Commission proposal permitted tariff-setting arrangements if they "confer[red] an equivalent advantage to the consumer, [were] not unduly restrictive and . . . a reasonable degree of competition [was] ensured."²⁵⁰ The Commission indicated that these conditions would be met if:

- i) airlines had an effective right of independent action, both in terms of proposing tariffs independently of other airlines,

²⁴⁶ The proposal called for two "zones of flexibility," each with a minimum range of 25 percent. The first zone was to "extend at least 15 percent on either side of the existing air fare for economy class," and the other was to "be suited below the first and cover restricted use air fares." *Id.* at Annex II, arts. 6(4) and (5).

²⁴⁷ *Id.* at 31.

²⁴⁸ *Id.* at 32.

²⁴⁹ *Id.* at 35.

²⁵⁰ *Id.*

and in terms of freedom to implement such tariffs, subject only to the [proposed] limited government control . . .

ii) the Member States concerned and the Commission were enabled to participate as observers in tariff consultations.²⁵¹

iii. Other Measures

The Commission gave inadequate and cursory treatment to the issue of market access, another major aspect of competition.²⁵² The Commission recognized the dominance throughout the EC of large, national airlines, and that services to the consumer would be improved with a proliferation of smaller airlines. It proposed, however, only that the smaller airlines be allowed to operate on bilateral routes not presently utilized.²⁵³ The Commission believed that neither "significant damage" to major airlines would result, nor would the detailed justification or reciprocity ordinarily required be necessary.²⁵⁴ Nonetheless, the Commission did suggest that if a Member State desired, smaller airlines could operate on unutilized routes, but only after giving national airlines rights of first refusal.²⁵⁵

The Commission also proposed tight control of state aid and subsidies to encourage airlines to accept competition. Without guarantees that other airlines would compete on the same level, airlines would be reluctant to join an open market.²⁵⁶ The Commission feared that unless state aids were adequately controlled, implementation of competition measures would result in a subsidy race, with competition financed by Member States.

The Commission proposed to prevent a subsidy race through application of the EEC Treaty's state aids rules in Articles 92 and 93.²⁵⁷ The Commission believed that proper application of these rules would result in advance disclosure of all proposed state aids so that the Commission could take a position whether it opposed individual subsidies or other forms of governmental assistance.²⁵⁸

²⁵¹ *Id.*

²⁵² See Thaine, *supra* note 68, at 93; International Chamber of Commerce (ICC), *European Commission Civil Aviation Memorandum No. 2*, 10 AIR L. 99, 103 (1985) (policy declaration and response adopted by the Executive Board of the ICC on Dec. 3, 1984).

²⁵³ MEMORANDUM 2, *supra* note 19, at 43-44.

²⁵⁴ *Id.*

²⁵⁵ *Id.* at 44.

²⁵⁶ Sorensen, *supra* note 9, at 7.

²⁵⁷ MEMORANDUM 2, *supra* note 19, at 36.

²⁵⁸ *Id.* at 37.

The Commission recognized that state aids might be appropriate in certain circumstances in order to fulfill public service obligations, compete with subsidized carriers from third countries, overcome "particularly precarious" but temporary financial problems, or to assist economically underdeveloped regions.²⁵⁹ The Commission also felt that assistance in the form of "normal commercial transactions," such as loans, capital, or guarantees, would be acceptable. However, cases would require individual examination to determine the presence of impermissible aid.²⁶⁰

The Commission's proposals in *Memorandum 2* also had international implications. Under Article 234 of the EEC Treaty,²⁶¹ Member States must take steps to eliminate provisions in agreements with third countries inconsistent with forthcoming Community aviation provisions. Nevertheless, the Commission agreed that some flexibility would be required, given the legitimate priorities and programs in third countries, especially non-Community members of ECAC.²⁶² Accordingly, the Commission entered into cooperation agreements under Article 229 with ECAC and EUROCONTROL, an air traffic management organization.²⁶³

Memorandum 2 also discussed a significant number of additional issues.²⁶⁴ The Commission attached six annexes which included detailed proposals for Council action and guidelines related to *Memorandum 2*'s contents.²⁶⁵ *Memorandum 2* was more than a general indication of the Commission's position and thoughts on European civil aviation. It was intended to provoke action by the Council and serve as a comprehensive guide to achieving the policy goals contained therein.

iv. Community Reaction

Industry and community reaction to *Memorandum 2* was mixed. IATA and AEA, while agreeing that reform was needed, published their own proposals which differed considerably from

²⁵⁹ *Id.* at 37, 38.

²⁶⁰ *Id.* at 38.

²⁶¹ EEC TREATY art. 234.

²⁶² MEMORANDUM 2, *supra* note 19, at 50.

²⁶³ *Id.*

²⁶⁴ *Id.* at 13, 48 (aircraft noise), 14 (search and rescue), 15 (accident investigation and interrogational air services), 19, 42 (air freight transport), 43 (access to market), 45 (non-scheduled services), 47 (social matters as related to Community and aviation policies), 48 (research), 49 (general aviation).

²⁶⁵ *Id.* at Annexes I-VI.

those contained in *Memorandum 2*.²⁶⁶ Perceiving significant threats to their economic well-being, trade unions and airports opposed *Memorandum 2*. By contrast, charter airlines and consumer groups voiced strong support for the Commission proposals, particularly in areas approached most warily by scheduled carriers.²⁶⁷ Parliament and the Community's Economic and Social Committee, an advisory body to the Commission and the Council, conducted extensive hearings and published comprehensive reports which supported the overall thrust of *Memorandum 2*, but which proposed significantly different approaches to many of the issues.²⁶⁸ The Council instituted a high-level working group which met eight times before the end of 1984. The efforts of the group culminated in a report which "can be said to build on *Memorandum 2*, taking into account the views that had been expressed in the interim."²⁶⁹ On December 11, 1984, the Council endorsed the report as a guideline for further actions and arranged for additional study.²⁷⁰

3. Enforcement

In 1986, following the Council's failure to adopt regulations implementing Articles 85 and 86 of the EEC Treaty, the Commission sent letters to ten European airlines alleging that they had violated the Treaty by engaging in price-fixing, capacity limitation, revenue pooling, and restricted market entry agreements.²⁷¹ The Commission threatened that the airlines' failure to cooperate and eliminate these anti-competitive practices would lead it to issue a "reasoned decision" under Article 89, an alternative which had been explicitly approved by the ECJ earlier that year in *Nouvelles Frontières*. Again, the issuance of a "reasoned decision" by the Commission on this matter would open a floodgate of litigation by private parties in the national courts of Member States.

Hence, the ten airlines—Air France, Aer Lingus, Alitalia, British Airways, British Caledonian, KLM, Lufthansa, Olympic, Sa-

²⁶⁶ WHEATCROFT & LIPMAN, *supra* note 78, at 52–53.

²⁶⁷ *Id.* at 53.

²⁶⁸ *Id.* at 53–54.

²⁶⁹ *Id.* at 54.

²⁷⁰ *Id.* at 55.

²⁷¹ EEC Commission Action Could Result in Suits Against 10 Large Carriers, *AV. WK. & SPACE TECH.*, July 14, 1986, at 35; Argyris, *supra* note 120, at 10–11.

bona, and SAS—had a strong incentive to comply. Although some of the southern European airlines initially resisted meeting with DG-4—the Commission ministry responsible for competition²⁷²—a more strongly worded Commission letter in early 1987 advised recalcitrant carriers that the Commission believed an apparent infringement of the EEC Treaty existed and that a “reasoned decision” would soon be forthcoming. This threat ultimately brought all ten carriers to the bargaining table. During tense meetings in Brussels, EC Competition Commissioner Peter Sutherland warned representatives of Alitalia, Lufthansa, and Olympic that unless they agreed to join negotiations on pricing liberalization, he would bring an action against them in the ECJ for operating an illegal cartel. The carriers capitulated.²⁷³

Yet, the informal understandings ultimately agreed upon between the Commission and the airlines were surprisingly modest in substance. These agreements allowed a great deal more anti-competitive activity than would be tolerated in the United States. As to pricing, they allowed a continuation of carrier discussions regarding rates. Furthermore, the agreements permitted carriers to enter into voluntary rate agreements as long as such discussions would not bind any carrier participating in them. In addition, they allowed the carriers to retain the right of independent action to file a tariff deviating from the agreed rates. Revenue and capacity pooling agreements would continue to be tolerated as long as they were voluntary, involved a sharing of revenue of no more than 1 percent, and the transfer of revenue went to the carrier providing off-peak service. Slot allocation would be permitted as long as negotiated and concluded publicly. Finally, airlines would have to provide equal and unbiased access to computer reservations systems.²⁷⁴

Thus, the Commission effectively did an “end run” around the Council, defining the perimeters of lawful vis-a-vis unlawful carrier conduct. It did so when the Council had been rendered immobile by an inability to reach a consensus on regulations implementing Articles 85 and 86 of the Treaty. Yet, the Commission’s modest constriction of anti-competitive air-carrier be-

²⁷² *Alitalia Rejects EEC Request for Data on Operational Practices*, AV. WK. & SPACE TECH., Nov. 17, 1986, at 39.

²⁷³ Giles Merritt, *EC Deregulation at Crossroads*, INT’L HERALD TRIB., June 15, 1987, at 9.

²⁷⁴ *Id.* at 9, 12.

havior surprised almost everyone, because the Commission had previously done so much "chest-beating."

D. *The Council*

The Council, which meets in Brussels and Luxembourg, comprises representatives appointed from each of the twelve Member States. Council members directly represent their states' interests.²⁷⁵ The Council has both legislative and executive powers²⁷⁶ and is responsible for carrying out the objectives of the Community and coordinating the economic policies of Member States.²⁷⁷ The Council can issue recommendations which are not binding on Member States,²⁷⁸ or it can issue decisions, directives, and regulations which are binding.²⁷⁹ The Council adopts regulations based upon recommendations and advisory opinions from the Commission or Parliament.²⁸⁰

In 1962, the Council adopted general competition rules, but specifically exempted air and sea transport. On June 30, 1968, the Council decided that competition laws should be made applicable to transport by rail, road, and inland waterway.²⁸¹ Air and sea transport were again excluded because of the special attitude toward these methods of transport which existed when the EEC Treaty was adopted in 1957.²⁸² Indeed, Council Regulation 141 states specifically that Council Regulation 17, which gives the Council the direct means of investigating violations of Articles 85 and 86 in transport and imposes penalties for failure to comply,²⁸³ does not apply to air transport and related activities.²⁸⁴

Many in Europe, including northern European governments and the Commission, implored the Council to adopt regulations

²⁷⁵ *Composition of the Council*, 3 Common Mkt. Rep. (CCH) ¶ 4406.02 (1978).

²⁷⁶ HENKEN, *supra* note 16, at 1078.

²⁷⁷ *Coordination of Economic Policies*, 3 Common Mkt. Rep. (CCH) ¶ 4402.04 (1978).

²⁷⁸ *Recommendations and Opinions*, 3 Common Mkt. Rep. (CCH) ¶ 4902.31 (1976) (CCH Explanation).

²⁷⁹ *Regulations*, 3 Common Mkt. Rep. (CCH) ¶ 4902.15 (1976) (CCH Explanation); *Decisions*, 3 Common Mkt. Rep. (CCH) ¶ 4902.25 (1976) (CCH Explanation).

²⁸⁰ *Functions of the Council*, 3 Common Mkt. Rep. (CCH) ¶ 4402 (1987).

²⁸¹ See 2 Common Mkt. Rep. (CCH) ¶¶ 2401-2634 (various dates) (Reg. No. 17).

²⁸² *Scope of Provisions on Transport*, 1 Common Mkt. Rep. (CCH) ¶ 1945.05 (1974).

²⁸³ MATHIJSEN, *supra* note 133, at 181-83.

²⁸⁴ Association of European Airlines, *European Air Transport Policy—AEA Proposals*, Sept. 27, 1985, at 14 (paper adopted by President's Special Assembly at Brussels).

specifying how to apply and enforce the competition laws.²⁸⁵ The major stumbling block in the adoption of competition regulations, however, was the desire of each nation to guarantee the success of its own airlines. Because Council members represent the interests of their own states, they must follow the policies of their governments.²⁸⁶

Article 74 of the EEC Treaty states that “[t]he objectives of this Treaty shall . . . be pursued by the Member States within the framework of a common transport policy.”²⁸⁷ Article 75 directs the Council to create common rules applicable to international transport within Member States.²⁸⁸ Despite a strong push for liberalization by the Commission in 1979 and 1984, and a decision by the ECJ in 1986, the Council pled impossibility. The issues were too complex and there was too much dissent within the Council itself.²⁸⁹

By mid-1987, the Council appeared poised to conclude a comprehensive agreement on defining the application of relevant provisions of the EEC Treaty to air transport. In particular, it was prepared to lay down detailed rules for the application of the competition provisions—Articles 85 and 86. It would also have identified the group exemptions allowed under these articles and included directives on scheduled airline fares, capacity, and market access.

Specifically, the package would have eliminated secret price-fixing, but would have allowed public and voluntary fare agreements between carriers. As to entry, instead of restricting airlines to regional routes between provincial airports, they would have been permitted to compete on feeder routes between regional and hub airports. The 50/50 capacity limitation agreements in many bilaterals would have been reduced to 45/55 for the first two years and 40/60 thereafter. Revenue pooling would have been

²⁸⁵ DEMPSEY, *supra* note 1, at 246; EEC TREATY art. 84(2).

²⁸⁶ DEMPSEY, *supra* note 1, at 98.

²⁸⁷ EEC TREATY art. 74.

²⁸⁸ *Id.* at art. 75.

²⁸⁹ See Bombardella, *supra* note 186, at 3; *Proceedings*, *supra* note 188, at 12. In 1978, the Council established a priority program to address the problem of air transport. The Council's priorities included: control of nuisances, simplification of formalities, implementation of technical standards, implementation of provisions regarding aid and competition, and mutual recognition of licenses. Other items of Council concern include: working conditions, the right of establishment, improvements in inter-regional services, search, rescue and recovery operations, and accident inquiries. Sorensen, *supra* note 9, at 3.

limited to 1 percent, and transferred to the carrier providing off-peak service. Computer reservation systems were to be open to all carriers without bias. The carriers would have been granted block exemptions from the competition rules to permit agreement on certain joint operations, such as scheduling.²⁹⁰ The entire package, accepted in principle by all Member States, foundered in mid-1987 on the question of the inclusion of Gibraltar in the proposed arrangements for route development.²⁹¹ Newly admitted Spain exercised its veto at the eleventh hour on an issue having virtually nothing to do with air transport.

Although the Spanish veto scuttled the mid-1987 agreement, the ability of the Council to reach a majority resolution of these issues in the future will be greatly facilitated by the weighted voting of Member States permitted by the Single European Act (SEA).²⁹² Under the SEA, no single nation will again be able unilaterally to thwart the Council's ability to promulgate rules by casting a veto as Spain did. Indeed, as discussed below, the SEA may have prompted Council agreement on a conservative liberalization package in December 1987.

V. THE SINGLE EUROPEAN ACT

The foregoing analysis of the functions and activities of the EC governing bodies would not be complete without an understanding of a major motivating force within the EC—the goal of a unified internal market, a European Union, by 1992.²⁹³ The SEA, which took effect in July 1987, was intended to facilitate and compel the creation of a European Union by this target date. Recently, a SEA provision allowing majority voting may have moved the Council to act on air transport. This provision replaced the previous requirement of unanimity in Council decisions.²⁹⁴

²⁹⁰ Merritt, *supra* note 273, at 9, 12.

²⁹¹ *Spain Blocks the Adoption of Air Deregulation in EC*, WALL ST. J., July 2, 1987, at 15; *Unfair Air Fares*, ECONOMIST, July 4, 1987, at 16; *Spain in Search of Europe*, ECONOMIST, July 18, 1987, at 43.

²⁹² See Single European Act, 1986 O.J. (L 169) 1.

²⁹³ *Creation of Internal Market*, 1 Common Mkt. Rep. (CCH) ¶ 202.07 (1978) (CCH Explanation) [hereinafter *Internal Market*]; see *They've Designed the Future, and It Might Just Work*, ECONOMIST, Feb. 13, 1988, at 45–48 [hereinafter *They've Designed the Future*]; Roger Thompson, *EC92*, NATION'S BUS., June 1989, at 18.

²⁹⁴ *Single European Act*, 1 Common Mkt. Rep. (CCH) ¶ 101.15 (1978) (CCH Explanation) [hereinafter *Single European Act*].

The attainment of a bona fide internal market in all economic sectors, including aviation, requires both the removal of trade barriers, and a "fusion of the members into a single economic area . . . extended to include freedom of movement of workers, the right of establishment, the free movement of services and capital, and a common transport policy."²⁹⁵ The Commission assumed a prominent role in urging and planning for this economic and political unification.²⁹⁶ In 1984, the Commission called attention to a marked slowdown in the progress toward the internal market throughout the 1970s. The Commission proposed the creation of a comprehensive program for the achievement of a genuine internal market.²⁹⁷ The program would include not just the simplification of procedures at intra-Community frontiers, but also the complete abolition of procedural formalities at the borders.²⁹⁸ The Commission also stated that the internal market would not be complete until citizens of the EC could reside in other Member States, even without economic justification.²⁹⁹

In June 1985, the Commission revealed a "White Paper," announcing proposals toward an internal market.³⁰⁰ This set of specific, detailed proposals was submitted for consideration at the Council's Milan meeting. Reciting the Community's recognized need for an internal market, the Commission indicated that a definite target date and detailed plans had been missing.³⁰¹ The Milan meeting was the juncture at which firm Community efforts commenced toward the creation and implementation of the

²⁹⁵ *Internal Market*, *supra* note 293, ¶ 202.07.

²⁹⁶ See *Proposals Aim to Strengthen the Community's Internal Market*, [1982-1985 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 10,415 (1982) (information memorandum from the Commission, June 1982); *Commission Submits Program for the Consolidation of the Internal Market*, [1982-1985 Transfer Binder] Common Mkt. Rep. (CCH) ¶ 10,595 (1984) (information memorandum from the Commission, June 1984) [hereinafter *Commission Submits Program*].

²⁹⁷ *Commission Submits Program*, *supra* note 296, ¶ 10,595.

²⁹⁸ *Id.*

²⁹⁹ *Id.*

³⁰⁰ *Completion of the Internal Market Sought by 1992*, 4 Common Mkt. Rep. (CCH) ¶ 10,693 (1985) (information memorandum from the Commission, June 1985).

³⁰¹ *Id.* In the bulletin announcing the White Paper, the Commission recited the need for removal of barriers in numerous sectors of the Community. The Commission also called for encouragement of industrial cooperation and the removal of disruptive taxation schemes as well as the free movement of goods and services. The Commission noted that removing barriers to the flow of services had proceeded more slowly than for goods, but reaffirmed and explained the importance of service industries. Service industries included "traditional" areas such as "banking, insurance, and transport." *Id.*

SEA.³⁰² Ultimately, the signatories of the SEA agreed to the target date of December 31, 1992.³⁰³

The SEA grew out of efforts, initiated by the European Council, to advance the EC toward a European Union.³⁰⁴ In response to the European Council's Solemn Declaration at Stuttgart in June 1983, the first draft of the treaty was presented in February 1984. The Act was signed by representatives of the twelve Member States on February 4, 1986, but it did not take effect until July 1, 1987, after ratification by all Member States.³⁰⁵ The majority of the SEA's provisions are amendments to the EEC Treaty or new provisions to be added to it.³⁰⁶ The SEA seeks to create a genuine internal market in which the remaining barriers to free movement of goods, persons, services, and capital are removed.³⁰⁷ In signing the SEA, the Member States committed themselves to establish an internal market by December 31, 1992, although this was in reality only a statement of political intent.³⁰⁸

The SEA made a number of institutional changes in the operation of the EC. It expanded the role of Parliament, granting it some degree of control over Council decisions. It also expanded and changed the role of the Commission, particularly regarding its interaction with Parliament. In addition, the SEA allowed the Council, at the request of the ECJ, to set up a court to hear such matters as appeals brought from Commission decisions on competition.³⁰⁹

Furthermore, the SEA removed a major barrier to the establishment of an internal market by replacing unanimous voting with qualified majority fifty-four out of seventy-six votes and

³⁰² *Single European Act a Milestone on the Road Toward a European Union*, 4 Common Mkt. Rep. (CCH) ¶ 10,812 (1986) (CCH Comment) [hereinafter *Milestone*].

³⁰³ *Single European Act*, *supra* note 294, ¶ 101.15.

³⁰⁴ *Id.* The European Council grew out of previously unsuccessful meetings of Heads of State and Government, starting in 1972, intended to solve economic, social, and political problems. Those attending the 1972 meetings decided to pursue the goal of attaining, by 1980, a European Union which would govern all relations between the Member States. This goal was confirmed at the Paris Summit in December 1974. At that time, it was formally decided to conduct such meetings three times a year and as otherwise necessary. These meetings were to constitute the European Council, and their purpose was to pursue solutions to the problems the ordinary Council could not solve. *European Union*, 1 Common Mkt. Rep. (CCH) ¶ 101.13 (1978) (CCH Explanation).

³⁰⁵ *Single European Act*, *supra* note 294, ¶ 101.15.

³⁰⁶ *Milestone*, *supra* note 302, ¶ 10,812.

³⁰⁷ *Single European Act*, *supra* note 294, ¶ 101.15.

³⁰⁸ *Milestone*, *supra* note 302, ¶ 10,812.

³⁰⁹ *Id.*

weighted voting—the larger nations have ten votes, the smallest have two—on a number of subjects, including development of a common transport policy.³¹⁰ A significant obstacle to the efficacy of majority voting, however, remained in the veto right which every country maintained.³¹¹ The veto right provided by the so-called Luxembourg compromise, was extracted by the French in 1966 in order to terminate General DeGaulle's "empty-chair" period, a boycott maintained to defend French sovereignty.³¹² This veto could not be overridden if a Member State declared a Council decision adverse to its vital national interests, and if enough other Member States agreed—which they usually did.³¹³

Two years after issuing the White Paper, the Commission stated in a second annual report, that "[t]he Community must do better" in order to achieve an internal market by 1992. The Commission cited numerous failures of its own, of the Council, and of Parliament to keep up with workloads. The Commissioners looked with optimism to the improved decision-making to be implemented through the SEA. The Commission stressed the importance of cooperative and expeditious involvement by officials of Member State governments and the necessity of not letting "national and sectorial interests take over."³¹⁴ To this end, the Commission has recognized the importance of a unified transport policy. Considering the importance of commercial aviation in the transportation infrastructure, initiatives directed toward liberalized competition and flexibility will assume critical importance.

VI. CONTEMPORARY AIR TRANSPORT POLICY OF THE EUROPEAN COMMUNITY

A. *The Council's First Phase of Liberalization (1987)*

In December 1987, three decades after the signing of the EEC Treaty, the Council adopted its long-awaited regulations on the application of the Treaty competition rules. After years of dispute, the Council finally achieved agreement for several reasons.

³¹⁰ *Id.*; *Single European Act*, *supra* note 294, ¶ 101.15.

³¹¹ *Don't Take Europa*, *supra* note 111, at 55; *Milestone*, *supra* note 302, ¶ 10,812.

³¹² *Don't Take Europa*, *supra* note 111, at 55.

³¹³ *Id.* The article adds that "[t]he veto power is often abused." *Id.*; *see also* *Milestone*, *supra* note 302, ¶ 10,812.

³¹⁴ *Faster Rate of Progress in the Completion of the Internal Market Needed*, 4 Common Mkt. Rep. (CCH) ¶ 10,882 (1987) (information memorandum from the Commission, May 1987).

In December 1987, Spain and the United Kingdom resolved their political problems surrounding the U.K.'s possession of Gibraltar, which had led Spain to veto the agreement earlier in the year.³¹⁵ Moreover, the prospect of weighted voting under the SEA had removed the possibility of a single state veto. Hence, no single nation could cause a repeat of the Spanish impasse of mid-1987. With weighted voting, consensus became more practical than intransigence.

Threats by the Commission to utilize the sanctions approved by the ECJ in *Nouvelles Frontières* also had abated considerably when it entered into relatively conservative agreements with offending airlines. Furthermore, the Commission itself began to appreciate the difficult political problems that international aviation posed for Member States. The Commission was now willing to opt for increased diplomacy over unilateral actions that might threaten the fragile European alliance.³¹⁶

Across the Atlantic, the U.S. experiment in deregulation was beginning to sour, dampening enthusiasm for radical liberalization in Europe. Even the most liberal of the EC members, Britain and the Netherlands, appeared to back away from their effort to accomplish U.S.-style deregulation. Moreover, new bilateral air transport agreements in effect between Britain, the Netherlands, Ireland, and many of their aviation partners liberalized much air transport in the EC.³¹⁷ ECAC itself adopted modest liberalization proposals. Hence, there was already much for the European scheduled air transport industry to digest.

For example, charter services, largely deregulated in the 1950s, dominated more than half of the air passenger market.³¹⁸ Intercity rail services were also responsible for a sizable portion of the transportation market. With increased privatization of carriers such as British Airways and KLM,³¹⁹ and proposed mergers

³¹⁵ *The Rock Stands Aside*, *ECONOMIST*, Dec. 5, 1987, at 55.

³¹⁶ As Peter Sutherland, EC Commissioner for Competition, noted "it was better to move this way than by confrontation, which would have taken longer and involved protracted legal battles." Susan Carey & Julie Wolf, *EC Adopts Plan to Partly Deregulate Europe's Airline Industry Starting in '88*, *WALL ST. J.*, Dec. 8, 1987, at 24.

³¹⁷ See DEMPSEY, *supra* note 1, at 102-04.

³¹⁸ *Id.* at 99.

³¹⁹ British Airways was completely privatized by the Thatcher government. KLM's government holdings have been reduced to 39 percent. P.C. Haanappel, *A Decade of Deregulation*, Address before the Aviation & Space Law Section of the Ass'n of American Law Schools 10 (Jan. 9, 1988) (on file with author).

in the offing, such as that between British Airways and British Caledonian, the market was already becoming increasingly competitive. The combination of all these factors made political consensus on a more conservative package easier to achieve, as southern European governments took a more conservative approach to air transport modifications.

The package (Phase One), effective January 1, 1988, provided for a three-year transition to a more liberalized air transport regime in areas of pricing, entry, and capacity, ostensibly attempting to meet the Community's ambitious 1992 deadline for a unified internal market.³²⁰ The regulations apply only to flights between Member States, and not to intra-nation flights or flights between Member States and third countries. Specifically, the Council regulations concerned: (1) scheduled air fares;³²¹ (2) capacity sharing and market access;³²² (3) scheduled air transport and the EEC Treaty's competition rules;³²³ and (4) group exemptions thereto.³²⁴ These regulations are discussed below.

1. Air Fares

The Council's *Directive on Scheduled Air Fares*³²⁵ gives to the aeronautical authorities of Member States the jurisdiction to approve carrier rates.³²⁶ Under this Directive, rates may be approved if "they are reasonably related to the long-term fully allocated costs" of the carrier.³²⁷ They will not be disapproved on grounds that the proposed rate "is lower than that offered by another air carrier operating on the route"³²⁸ Moreover, the Directive establishes two zones of pricing flexibility: a discount zone, extending from 90 percent to more than 65 percent of the referenced fare; and, a deep-discount zone, running from 65 to 45 percent of the referenced fare.³²⁹ Although the conditions

³²⁰ See *They've Designed the Future*, *supra* note 293, at 45.

³²¹ Council Directive 87/601, 1987 O.J. (L 374) 12.

³²² Council Decision 87/602, 1987 O.J. (L 374) 19. The regulations are set forth in Paul S. Dempsey, *Aerial Dogfights Over Europe: The Liberalization of EEC Air Transport*, 53 J. AIR L. & COM. 615, 687-736 (1988).

³²³ Council Regulation 3975/87, *supra* note 205.

³²⁴ Council Regulation 3976/87, *supra* note 154.

³²⁵ Council Directive 87/601, *supra* note 321.

³²⁶ *Id.* at art. 4.

³²⁷ *Id.* at art. 3.

³²⁸ *Id.*

³²⁹ *Id.* at art. 5. The "referenced fare" is the "normal economy air fare charged by a third- or fourth-freedom air carrier on the routes in question" *Id.* at art. 2(c).

attached to these fares—advance purchase requirements, minimum and maximum lengths of stay, and age restrictions³³⁰—are rigid, within these zones carriers may set their prices freely without government restrictions.³³¹

2. Capacity Sharing and Market Access

In the Council *Decision on Capacity Sharing and Market Access*,³³² the traditional 50/50 split of capacity between European carriers was abandoned in favor of an immediate 55/45 percent rule from January 1, 1988 to September 30, 1989. A 60/40 split was implemented after October 1, 1989.³³³ The Decision, however, includes an escape clause enabling any Member State to petition the Commission to postpone or cancel the 60/40 rule on grounds that its flag carriers have suffered “serious financial damage.”³³⁴

The Decision also established new entry opportunities of multiple designation over routes having more than 250,000 passengers. The threshold of passengers would be reduced in the second and third year to 200,000 and 180,000 respectively;³³⁵ this is equivalent to 1,200 and 1,000 return flights respectively. In addition, significant new opportunities for entry have been created between hub and regional airports,³³⁶ and for Fifth Freedom rights.

3. Scheduled Air Transport and Competition Rules

The original Council regulations excluded the transport sector from the application of the competition rules.³³⁷ Hence, the *Regulation on the Application of the Competition Rules*³³⁸ became the first to apply Articles 85 and 86 of the Treaty to air transport. This

³³⁰ *Id.* at Annex II.

³³¹ *Id.* at art. 5.

³³² Council Decision 87/602, *supra* note 322.

³³³ *Id.* at art. 3.

³³⁴ *Id.* at art. 4.

³³⁵ *Id.* at art. 5.

³³⁶ *Id.* at art. 6.

³³⁷ Pursuant to Council Regulation 141, Regulation 17 was made inapplicable to transportation. Subsequently, the Council adopted Regulation 1017/68 to apply the competition rules to inland transport. And more recently, it adopted Regulation 4056/86, applying the rules to maritime services. See DEMPSEY, *supra* note 1, at 245; Council Regulation 4956/86, 1986 O.J. (L 378) 4.

³³⁸ Council Regulation 3975/87, *supra* note 205.

regulation explicitly conferred jurisdiction to the Commission to hear complaints regarding violations of Articles 85(1) and 86 brought by Member States or by natural or legal persons having a legitimate interest.³³⁹ The regulation gave the Commission powers of investigation³⁴⁰ and the authority to levy fines against enterprises found to have violated the EEC Treaty.³⁴¹

4. Group Exemptions to Competition Rules

Pursuant to Article 85(3) of the Treaty, which authorizes the establishment of group exemptions from the competition rules, the Council adopted regulations implementing procedures for their creation.³⁴² The Council conferred the Commission with significant powers to adopt regulations authorizing carriers to engage in agreements on, *inter alia*, capacity and revenue sharing, rates, slot allocations, computer reservations systems, and ground handling.³⁴³ Utilizing its new powers, the Commission promptly promulgated three regulations establishing the requirements for airline group exemptions authorized under Article 85(3).³⁴⁴ Those regulations are discussed below.

B. *The Commission's Regulations for Block Exemptions (1987)*

On July 26, 1987, the Commission adopted regulations implementing block exemptions to the application of Article 85(3) of the EEC Treaty. The areas covered include: (1) capacity, revenue pooling, tariff consultations, and slot allocations (airline agreements regulation);³⁴⁵ (2) computer reservations systems (CRS regulation);³⁴⁶ and (3) ground handling services (ground handling regulation).³⁴⁷ These rules came into force on January 1, 1988.

³³⁹ *Id.* at art. 3. Exceptions for technical agreements are set forth at *id.* at art. 2.

³⁴⁰ *Id.* at art. 11.

³⁴¹ *Id.* at art. 12(2).

³⁴² Council Regulation 3976/87, *supra* note 154.

³⁴³ *Id.* at art. 2.

³⁴⁴ Commission Regulation 2671/88, *supra* note 154; Commission Regulation 2672/88, 1988 O.J. (L 239) 13; Commission Regulation 2673/88, 1988 O.J. (L 239) 17. These regulations were effective until January 1, 1991.

³⁴⁵ Commission Regulation 2671/88, *supra* note 154.

³⁴⁶ Commission Regulation 2672/88, *supra* note 344.

³⁴⁷ Commission Regulation 2673/88, *supra* note 344.

1. The Airline Agreements Regulation

a. *Capacity Sharing*

Under the airline agreements regulation, capacity limitation agreements between airlines must have a satisfactory spread of regular and reliable service over less busy periods. They cannot result in anti-competitive market segmentation. Airlines must be free to withdraw without penalty from capacity limitation agreements on short notice.³⁴⁸

b. *Revenue Pooling*

In order to utilize the group exemption for revenue pooling, the airline agreements regulation requires that the carrier offering the less favorable schedule—service at less busy times of day and less busy periods of the travel season—must receive the economic transfer. The transfer must also be determined prior to the offering of the service, on the basis of the schedule of the pool participants. The regulation imposes a 1 percent ceiling on the transfer of revenue, exclusive of shared costs. Moreover, each carrier is guaranteed flexibility as to capacity offered.³⁴⁹

c. *Tariff Consultations*

The Council indicated that tariff consultations should be voluntary, their results nonbinding upon participating airlines, and that observers from the Commission and Member States should be invited to attend. The Commission's regulation goes further, however, by opening access to any airline which has applied to operate the route in question. The regulation limits consultations to scheduled airline tariff matters, and they may not embrace capacity limitations or travel agent compensation. The resulting rates must not discriminate based on the nationality or residence of the passengers. The regulation gives carriers a right of independent action in offering a rate outside that agreed to in the consultations.³⁵⁰

³⁴⁸ Argyris, *supra* note 120, at 24–25.

³⁴⁹ *Id.* at 26–27.

³⁵⁰ Commission Regulation 2671/88, *supra* note 154, at art. 4.

d. *Slot Allocation and Airport Scheduling*

The Commission's regulation on slot allocation and airport scheduling is designed to ensure that all interested carriers may freely participate in relevant discussions. Slot allocation rules must be clear and fairly applied.³⁵¹ Furthermore, priority rules may not be related to the identity of any airline.

2. The Computer Reservation System (CRS) Regulation

The Commission's block exemption for CRS joint ventures exempts exclusivity and non-competition clauses essential for continental operation and marketing.³⁵² The regulation requires a CRS to display neutrally the flights of airlines seeking access and to make available its services to participating airlines. A CRS may not discriminate in the fees charged or services provided. Unlike a U.S. CRS, a European CRS may not penalize travel agents who terminate its contracts. Travel agents may freely end their contracts on short notice, and may subscribe to more than a single CRS system. Commissions paid to travel agents may not be linked to the volume of bookings made in the system in which the airline has an economic interest. Finally, under the regulation, no CRS may engage in practices designed to partition the market.³⁵³

3. The Ground Handling Regulation

The Commission's ground handling regulation ensures that a purchaser of such services may switch to another supplier on short notice. Additionally, purchasers can transact business with multiple suppliers.³⁵⁴ The regulation also ensures the absence of discrimination between airlines.³⁵⁵

C. *The Council's Second Phase of Liberalization (1990)*

In June 1990, the Council adopted regulations (1990 regulations) governing scheduled intra-Community air transporta-

³⁵¹ Argyris, *supra* note 120, at 29.

³⁵² *Id.* at 29–30.

³⁵³ *Id.* at 29–31.

³⁵⁴ *Id.* at 31–32.

³⁵⁵ Smeathers, *European Liberalization—Turbulence En Route*, IATA REV. (Jan.–Mar. 1989) at 3, 4.

tion.³⁵⁶ The regulations were adopted in response to the Commission's September 1989 proposals for liberalizing tariffs, market access, and capacity.³⁵⁷ Those and other issues are discussed below.

1. Pricing

Under the 1990 regulations, affected Member States must approve fares.³⁵⁸ For the first time in EC history, however, the tariff regulations embrace the double disapproval system for tariffs that exceed the referenced rate by at least 5 percent. On January 1, 1993, the double disapproval system will be expanded to apply to all rates.³⁵⁹

Under the 1990 regulations, Member States must approve air fares of EC carriers which reasonably relate to the carriers' long-term, fully-allocated costs. Proposed fares cannot be disapproved because they are lower than current fares.³⁶⁰ Member States can submit rate disagreements to arbitration.³⁶¹

The 1990 regulations permit carriers to charge 95 percent to 105 percent of the reference tariff for a "normal class economy ticket." The reference fare is the average normal economy air fare on the route in question.³⁶² The regulations narrow the discount zone to between 94 and 80 percent. The regulations also expand the deep-discount zone to between 79 and 30 percent. Member States must approve any rate within the zone.³⁶³ This narrowing allows much more rate flexibility than Phase One permitted.³⁶⁴ Restrictions under Phase One limited the applicability of the discount zone to Saturday night stayovers and six-night excursions or off-peak travel. The restrictions generally have been eliminated, although some remain in effect for the deep-discount zone.

³⁵⁶ Council Regulation 2342/90, 1990 O.J. (L 217) 1; Council Regulation 2343/90, 1990 O.J. (L 217) 8.

³⁵⁷ See COM(89)417 final.

³⁵⁸ Council Regulation 2342/90, *supra* note 356, at art. 4(1).

³⁵⁹ *Id.* at art. 4(6).

³⁶⁰ *Id.* at art. 3(1)(4).

³⁶¹ *Id.* at art. 6(4)–(9).

³⁶² *Id.* at art. 2(i).

³⁶³ *Id.* at Annex II.

³⁶⁴ See Werner F. Ebke & Georg W. Wenglorz, *Liberalized Scheduled Air Transport Within the European Community: From the First Phase to the Second and Beyond*, 19 DEN. J. INT'L L. & POL'Y 493, 519 (1991).

Under the 1990 regulations, a Member State with a legitimate interest in the market may request that the Commission review a tariff outside the flexibility zones to determine whether another Member State has satisfied its obligations. The Commission can determine whether unreasonably high tariffs are in the consumers' best interest. The Commission may also decide whether carriers are "dumping" to drive other airlines from the market.³⁶⁵ Additionally, the 1990 regulations permit lower fares within the zones in the Third and Fourth Freedom markets,³⁶⁶ as well as in the Fifth Freedom markets.

2. Market Access

Under the 1990 regulations, Member States must allow the airlines of other Member States to use the Third and Fourth Freedom routes on a reciprocal basis.³⁶⁷ This reciprocity may cause a carrier operating from a slot-constrained airport to be denied new authority to fly to less frequently served foreign airports. Airlines based in the underutilized foreign airports, however, may receive reciprocal rights to serve in the slot-constrained airport.³⁶⁸ The 1990 regulations also allow multiple carrier designation on dense routes.³⁶⁹ Finally, the 1990 regulations permit airlines to dedicate up to 50 percent of their seating capacity to Fifth Freedom routes, up from Phase One's 30 percent allowance.³⁷⁰

3. Capacity Sharing

As to capacity sharing, the 1990 regulations extend the 60/40 percent ratio approved under Phase One by 7.5 percent beginning November 1, 1990.³⁷¹ The Commission, however, may limit capacity growth if it causes substantial damage to an airline.³⁷²

³⁶⁵ Council Regulation 2342/90, *supra* note 356, at arts. 3(3), 5.

³⁶⁶ *Id.* at arts. 3(6), 4(5). Third Freedom movements involve air transit from an airline's nation of registry to another nation. Fourth Freedom involves flights from another country to an airline's nation of registry. DEMPSEY, *supra* note 1, at 11, 49–50.

³⁶⁷ Council Regulation 2343/90, *supra* note 356, at art. 5(1).

³⁶⁸ Ebke & Wenglorz, *supra* note 364, at 523.

³⁶⁹ Council Regulation 2343/90, *supra* note 356, at art. 6(2).

³⁷⁰ *Id.* at art. 8(1).

³⁷¹ *Id.* at art. 11(1).

³⁷² *Id.* at art. 11, 12.

4. Other Issues

The Council rejected the Commission's proposals for the elimination of cabotage restrictions.³⁷³ It also failed to extend antitrust exemptions to domestic flights and flights to third countries. It did so despite the holding in *Ahmed Saeed* that the competition provisions of the EEC Treaty are applicable to such operations.³⁷⁴

D. *The Commission's Proposed Third (and Final?) Phase of Liberalization (1991)*

On July 17, 1991, the Commission endorsed a three-part legislative package (1991 proposal) designed to complete air transport liberalization within the Community by January 1, 1993.³⁷⁵ The proposal included recommendations on rates, freedom of establishment, and capacity and entry.³⁷⁶ To date, however, neither the Council nor Parliament has accepted the recommendations.

1. Rates

The 1991 proposal would continue the current reliance on the double disapproval approach to ratemaking. A rate higher than 105 percent of the published reference rate can be rejected only if both states reject it.³⁷⁷ Where competition is limited in a market, a Member State could ask the Commission to approve or reject the proposed rate.³⁷⁸ The Commission plans a complete liberalization of fares beginning in 1996, except in markets where competition is limited.³⁷⁹

2. Freedom of Establishment

The 1991 proposal would impose two requirements for an airline to operate throughout the Community. First, the carrier

³⁷³ Ebke & Wenglorz, *supra* note 364, at 525. Cabotage restrictions prohibit foreign airlines from serving domestic markets, or stated differently, from providing service between two points located within the same nation. See DEMPSEY, *supra* note 1, at 78-79, 112, 384.

³⁷⁴ See Ebke & Wenglorz, *supra* note 364, at 526.

³⁷⁵ Berend J.H. Crans & Edith M.H. Loozen, *EC Aviation Scene*, 16 AIR L. 178, 179 (1991).

³⁷⁶ *Id.* at 188-92.

³⁷⁷ *Id.* at 192-93.

³⁷⁸ *Id.*

³⁷⁹ *Id.* at 191-92.

would be required to satisfy technical and safety standards in order to obtain an Air Operator's Certificate.³⁸⁰ Second, the proposal would require the airline to satisfy certain geographic and nationality requirements, as well as economic standards. These standards include a minimum capital requirement of 100,000 European Currency Units (ECUs)—approximately \$125,000—and insurance requirements in order to acquire an Operating License.³⁸¹ The 1991 proposal would also eliminate nationality restrictions, effectively granting reciprocal cabotage rights.³⁸²

3. Capacity and Entry Liberalization

The 1991 proposal would also enhance competition on intra-Community routes by ending capacity restrictions and authorizing Fifth Freedom rights.³⁸³ Thus, Community airlines would have the freedom to operate within and between points in nations other than those of their flags. Capacity limitation and pooling agreements would no longer be exempt from the operation of Article 85.³⁸⁴ Moreover, all rules would be made applicable to domestic air transportation.

4. Adoption of the 1991 Proposal

The 1991 proposal will not be effective until approved by the Council and Parliament. As of this writing, it appears that the Council will adopt measures for mutual approval of pilot and mechanic licensing and harmonization of technical standards. Market access and rate regulation issues, however, will likely be left until later.³⁸⁵

VII. EC MERGER REGULATIONS

The 1989 Merger Regulations are particularly relevant to air transport, given the outbreak of mergers and consolidations likely to result from liberalization. These regulations give the Commission the power to halt mergers before they irreversibly alter the

³⁸⁰ *Id.* at 188.

³⁸¹ *Id.* at 189–90.

³⁸² *Id.* at 179.

³⁸³ *Id.* at 190–91.

³⁸⁴ *Id.* at 181.

³⁸⁵ Brian Coleman, *Air Deregulation Top EC Agenda at Brussels Session*, WALL ST. J., Dec. 15, 1991, at A9a.

structure of the market.³⁸⁶ Furthermore, the Commission has jurisdiction to oversee "all proposed mergers, acquisitions, and other business combinations having a '[C]ommunity dimension.'"³⁸⁷

The merger rules define Community dimension in terms of worldwide turnover and Community-wide turnover. The aggregate worldwide turnover must exceed 5 billion ECUs—approximately \$6.2 billion—and the turnover of at least two of the undertakings must exceed 250 million ECUs—approximately \$310 million.³⁸⁸ When, however, each undertaking achieves two-thirds of its Community-wide turnover in a single EC state, the merger does not have a Community dimension.³⁸⁹ These thresholds are subject to review in four years, at the completion of the internal market.³⁹⁰ It is anticipated that the thresholds will be lowered to ECU 1 billion worldwide turnover and ECU 100 million Community-wide turnover.³⁹¹ The existing thresholds are probably too high to prevent most airline mergers.³⁹² The relevant geographic market for purposes of evaluating the potential anti-competitive effect of a merger has both foreign and EC dimensions. Hence, the Commission could exempt a merger which has positive competitive effects on a global scale, despite adverse intra-Community effects.³⁹³

British Airways consummated its acquisition of British Caledonian before the merger rules became effective.³⁹⁴ Air France's acquisition of the French flag airline UTA, however, occurred after the merger rules became effective.³⁹⁵ Although Air France and UTA may technically have been exempt from the rules on

³⁸⁶ Gordon B. Dunn, Note, *EC Merger Control and 1992: Can the New Regulation Meet the Challenges of the Common Market?*, 23 N.Y.U. J. INT'L L. & POL. 115 (1990).

³⁸⁷ Marsha Cope Huie & Stephen D. Hogan, *The New European Community Merger Control Regulation and the Short-Term Horizon of United States Firms*, 6 AM. U.J. INT'L L. & POL'Y 325, 327 (1991).

³⁸⁸ Council Regulation 4064/89, art. 1(2), 1989 O.J. (L 395) 1.

³⁸⁹ *Id.*

³⁹⁰ *European Commission Warns Airlines on Mergers, Competition*, AV. DAILY, Apr. 28, 1989.

³⁹¹ Dunn, *supra* note 386, at 142.

³⁹² John Balfour, *Airline Mergers and Acquisitions: What Controls Does EEC Law Provide?*, 15 AIR L. 237, 241 (1990).

³⁹³ Dunn, *supra* note 386, at 144.

³⁹⁴ *Id.*

³⁹⁵ *Competition: EEC Decisions, Monthly Report on Europe*, Nov. 1990, at 11, available in LEXIS, European Library, MDNREP file.

grounds that more than two-thirds of their turnover was attributable to France—the nation whose flag they flew—they nonetheless agreed to accept conditions proposed by the Commission.³⁹⁶ The Commission also approved KLM's acquisition of the Dutch charter airline, Transavia.³⁹⁷

VIII. EUROPEAN COMMUNITY REGULATION OF NON-ECONOMIC ISSUES

A. *Air Traffic Congestion and Safety*

The Council adopted a resolution in July 1989 calling for the implementation of measures designed to address the anticipated doubling of air traffic—and therefore airport congestion—by the year 2000. The measures include replacing the eight systems governing EC air traffic.³⁹⁸ The resolution gives EUROCONTROL enhanced responsibility to coordinate air traffic management. It does so by overseeing the planning and acquisition of navigation facilities by Member States and developing common air traffic control procedures and training programs. The Council also gave EUROCONTROL jurisdiction to establish a centralized air traffic control system.³⁹⁹

In October 1990, the Commission proposed that the Joint Aviation Authorities—comprising representatives of the aviation departments of the Member States—be given formal jurisdiction to coordinate civil aircraft safety and technical issues.⁴⁰⁰ The Commission has also proposed that the Council adopt regulations calling for the mutual recognition of civil aviation personnel licenses.⁴⁰¹ Additionally, as of this writing, the Commission is preparing rules which would harmonize working conditions of airline crews.⁴⁰²

³⁹⁶ *Id.*

³⁹⁷ *Commission Approves KLM/Transavia Deal*, Common Mkt. Rep. (CCH) ¶ 96,003 (1991).

³⁹⁸ Resolution of the Council and the Ministers for Transport, Meeting within the Council, of 18 July 1989 on Air Traffic System Capacity, 1989 O.J. (C 189) 1.

³⁹⁹ See *Transport*, Coopers & Lybrand, July 4, 1991, available in LEXIS, Europe Library, Eurescope File, at 8.2 [hereinafter *Transport*].

⁴⁰⁰ Proposal for a Council Directive on the Harmonization of Technical Requirements and Procedures Applicable to Civil Aircraft, 1990 O.J. (C 270) 1.

⁴⁰¹ *Transport*, *supra* note 399, at 8.5.

⁴⁰² *Id.* at 8.6.

B. *Noise Limitations*

The Council has adopted a directive which bans the addition of aircraft to EC airline fleets which do not satisfy Chapter 3 of the Chicago Convention.⁴⁰³

C. *Denied Boarding Compensation*

On December 18, 1990, the Council adopted a regulation which established rules for denied boarding compensation.⁴⁰⁴ On over-booked flights, airlines must first ask volunteers to take a later flight—with compensation. If there are not enough volunteers, those passengers holding free or reduced rate tickets will be the first “bumped” from the flight. Certain passenger groups have top priority to board: those flying because of the death or illness of a relative or friend; the disabled; the elderly; and unaccompanied children.⁴⁰⁵ Compensation in the amount of 150 ECUs—approximately \$190—for flights up to 3,500 kilometers and 300 ECUs—approximately \$375—for longer flights, will have to be paid by the airline.⁴⁰⁶

IX. THE FUTURE OF EUROPEAN AIR TRANSPORT

The year 1992 was undoubtedly too ambitious a target for comprehensive European unification of the nature intended by the SEA. Nonetheless, because unification may be achieved eventually, the relevant question is what gradual unification will mean for air transport. All nations have traditionally guarded their sovereignty over aviation, allowing airlines owned by foreign nationals to enter their own markets only on a reciprocal basis, carefully negotiated in a series of bilateral air transport agreements.

Today, Phillips, the Dutch electronics firm, can build a manufacturing facility in Barcelona with relative ease. If, however, KLM Royal Dutch Airlines sought to establish hub-and-spoke operations centered in Barcelona, the Spanish Air Force would likely be scrambled to escort the KLM jets out of sovereign Spanish airspace. Nevertheless, if Europe is to achieve a unified econ-

⁴⁰³ Council Directive 89/629, 1989 O.J. (L 363) 27.

⁴⁰⁴ Council Regulation 295/91, 1991 O.J. (L 36) 1.

⁴⁰⁵ *Transport*, *supra* note 399, at 8.7.

⁴⁰⁶ Council Regulation 295/91, 1991 O.J. (L 36) 5.

omy, KLM should have the freedom to enter and exit markets that Phillips enjoys. If so, the traditional notion of air sovereignty, and the complex matrix of bilateral air transport agreements which codify the concept, must be superseded by a regime which treats all of the EC as a domestic cabotage market. If this occurs, Lufthansa will be able to make a hub of Lyon, and Air France a hub of Munich, without governmental interference.

Another traditional concept which already appears to be crumbling is the notion of "effective ownership and control" of a flag-carrier by citizens of its nation. For example, where the Ireland-Portugal bilateral air transport agreement allowed a carrier flying the flag of each nation to serve the Dublin-Lisbon market, it was required that each nation's carrier be effectively owned and controlled by citizens of the nation whose flag the airline flew. Thus, more than 50 percent of Aer Lingus is owned by Irish nationals, and more than 50 percent of TAP, the Portuguese flag-carrier is owned by Portuguese nationals. Effective ownership and control was a concept which had long dominated the air transport relations of most nations, although a few multinational carriers existed here and there. Under the 1991 proposal, an airline registered in any Member State would have virtually unhindered freedom to transport passengers in any intra-Community cabotage or Fifth Freedom market. Hence, entry would largely be deregulated.

With their eyes on the U.S. megacarriers which have emerged from U.S. deregulation—where fewer than a half-dozen airlines control more than 80 percent of the U.S. domestic market—privatization and merger discussions between carriers have become increasingly popular in Europe. Already, Scandanavian Airlines System (SAS) has announced, and subsequently abandoned, plans to merge with Sabena. Recently privatized British Airways acquired British Caledonian, also a target of SAS.⁴⁰⁷ Alitalia has also expressed an interest in securing a merger partner.

The five largest EC airlines—British Airways, Air France, Lufthansa, KLM, and Iberia—account for nearly 70 percent of sched-

⁴⁰⁷ Paul Hemp, *British Airways Wins Caledonian By Increasing Bid to \$457.9 Million*, WALL ST. J., Dec. 22, 1987, at 18; Paul Hemp, *SAS Bids for Part of British Caledonian, Which Favors the Offer Over British Air's*, WALL ST. J., Dec. 10, 1987, at 18; John Marcom, *U.K. to Review British Air Plan for a Takeover*, WALL ST. J., Aug. 7, 1987, at 20; Giles Merritt, *For EC 'Flag Carriers,' Partnerships May Be a Necessity*, INT'L HERALD TRIB., June 15, 1987, at 9.

uled European traffic.⁴⁰⁸ Jan Carlzon, president of SAS, predicts that ultimately only five airlines will survive liberalization, and obviously wants SAS to be among them.⁴⁰⁹ The global impact of deregulation is predicted to result in a consolidation of the industry into fifteen to twenty multinational airlines, competing in markets around the world.⁴¹⁰

If the U.S. experience is any indication of what will occur in a liberalized regulatory environment in the EC, bankruptcies, consolidations, and mergers will result in a highly concentrated group of multinational EC megacarriers. These megacarriers would all utilize hub-and-spoke operations and would be linked to only a few sophisticated computer reservations systems.⁴¹¹ In the short run, passengers will enjoy lower ticket prices as carriers become hotly competitive, because their profit margins will be severely squeezed by new entrants.⁴¹² Passengers will enjoy those benefits at the cost of deterioration in labor-management relations, the margin of safety, small community access, and an overall decline in the quality of airline service.⁴¹³ Many smaller carriers and most new entrants will fall into bankruptcy, unless they can align themselves as feeders for the megacarriers.⁴¹⁴ The charter

⁴⁰⁸ *European Deregulation Expected to Lead to Airline Mergers*, AV. WK. & SPACE TECH., Mar. 9, 1987, at 203. British Airways alone accounts for 22 percent of all EC revenue passenger miles, even without its acquisition of British Caledonian. *Id.*

⁴⁰⁹ Susan Carey, *European Airlines Discuss Joining Forces*, WALL ST. J., June 10, 1987, at 16.

⁴¹⁰ Daniel M. Kasper, *Toward Open Skies World-Wide*, WALL ST. J., Aug. 3, 1987, at 17.

⁴¹¹ The emergence of European computer reservations systems (CRS) has already begun, with British Airways, KLM, and Swissair linking themselves in a joint venture with United Airlines and its Covia reservations system. Robert L. Rose, *Allegis Aims for More Profit, Passengers with European Reservations Venture*, WALL ST. J., July 13, 1987, at 2. Recently, Allegis announced its intention to sell 35 percent of its Covia system to British Airways, Swissair, KLM, and Alitalia. *Allegis Discloses More on 50% Sale of Its Covia Unit*, WALL ST. J., Feb. 19, 1988, at 36. Meanwhile, Air France, Lufthansa, Iberia, and SAS have teamed with Texas Air's System One CRS to form the Amadeus computer reservations system.

⁴¹² Paul S. Dempsey, *The Experience of Deregulation: Erosion of the Common Carrier System*, 13 TRANSP. L. INST. 121, 172-75 (1980).

⁴¹³ Paul S. Dempsey, *The Dark Side of Deregulation: Its Impact on Small Communities*, 39 ADMIN. L. REV. 445 (1987); *Turbulence*, *supra* note 9, at 387-88; Paul S. Dempsey, *Transportation Deregulation—On a Collision Course?*, 13 TRANSP. L.J. 329, 342-64 (1984); Paul S. Dempsey, *With Deregulation, Big Get Bigger*, PHIL. INQUIRER, Dec. 19, 1987, at 9A; Paul S. Dempsey, *Deregulation's First Decade*, J. OF COM., Dec. 18, 1987, at 8A; Paul S. Dempsey, *Punishing Smallness*, CLEV. PLAIN DEALER, Dec. 12, 1987, at 15A; Hobart Rowen, *Airline Service Has Gone to Hell*, WASH. POST, July 23, 1987, at A21; Paul S. Dempsey, *Consumers Pay More to Receive a Lot Less*, USA TODAY, July 16, 1987, at 8A.

⁴¹⁴ Paul S. Dempsey, *Antitrust Law & Policy in Transportation: Concentration Is the Name*

airline industry will shrink radically or disappear. Once the remaining airlines have achieved consolidation into a handful of megacarriers, ticket prices will both rise and become monstrously discriminatory.⁴¹⁵

The enthusiasm for liberalization has waned somewhat as Europeans have observed the massive shakeout occurring across the Atlantic in the decade-old U.S. experiment in deregulation. Nevertheless, nations such as Great Britain and the Netherlands, which believe both consumers and airlines will ultimately benefit from the forces of the marketplace, have exerted considerable pressure for liberalization.⁴¹⁶ The increasing number of liberal bilateral agreements is evidence that the European nations are creating a more free market-oriented air transport system. Individual airlines are also taking direct action against restraints to air transport. Nations and airlines opposed to deregulation are being increasingly subjected to market forces to which they must respond or risk losing ground to the more flexible, less-regulated States and increasingly privatized carriers. Industry organizations have tremendous influence in the EC air transport industry. ECAC has made significant strides toward liberalization with its recent Memoranda of Understanding on tariffs and capacity. Although the interests and objectives of each organization are different, there is growing support for modest liberalization from these bodies as well.

CONCLUSION

The EC was established to promote a free market among Member States. Actions by the Community were delayed by political

of the Game, 21 GA. L. REV. 505 (1987); Paul S. Dempsey, *Birth of the Monster Airlines*, TRAFFIC WORLD, Dec. 1, 1986, at 77; Rose, *Major U.S. Airlines Rapidly Gain Control Over Flying Low*, ROCKY MTN. NEWS, Aug. 9, 1987, at 73; Paul S. Dempsey, *The Carnage of Airline Deregulation*, HOUS. CHRON., July 30, 1987, at 27; Paul S. Dempsey, *Consolidation, a Destructive Trend*, DENV. POST, Dec. 6, 1986, at 4B; Paul S. Dempsey, *Deregulation's Toll Is Rising*, DENV. POST, Sept. 4, 1986, at 5B; Paul S. Dempsey, *Deregulated Skies Unfriendly to Small Airlines*, ROCKY MTN. NEWS, May 25, 1986, at 77; Paul S. Dempsey, *Airline Deregulation's Hostile Skies*, DENV. POST, Oct. 17, 1983, at 3B; Paul S. Dempsey, *Affordability, Safety of Airlines May Suffer*, L.A. TIMES, Oct. 11, 1983, at 7; Hobart Rowen, *Airline Deregulation: A Bankrupt Policy*, WASH. POST, Sept. 29, 1983, at A21; see DEMPSEY & THOMS, *supra* note 27, at 245-51.

⁴¹⁵ See generally PAUL S. DEMPSEY, *FLYING BLIND: THE FAILURE OF AIRLINE DEREGULATION* (1990); PAUL S. DEMPSEY, *THE SOCIAL AND ECONOMIC CONSEQUENCES OF DEREGULATION* (1989).

⁴¹⁶ *Increased Liberalization*, *supra* note 10, at 36.

considerations and by the reluctance of a few nations that own or subsidize their national airlines. While unable to accomplish immediate deregulation, the EC helped generate public support that pressured governments towards more bilateral agreements to ease regulation. Through its governing bodies, the EC contributed to the creation of a governmental climate favoring partial liberalization. Much progress has been achieved toward that objective with the Council's promulgation of its long-awaited regulations, group exemptions, directives, and decisions.

Although it is far from clear what the final result of these forces favoring liberalization of air transport regulations will be, it is obvious that significant liberalization in the regulatory environment of EC air transport is occurring and that this trend is likely to continue. Whether it will ultimately mirror U.S.-style deregulation or a more modest form of regulatory liberalization, as many EC officials insist, is as yet unclear.